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## Why Own the Farm If You Can Own the Farmer (and the Crop)?: Contract Production and Intellectual Property Protection of Grain Crops

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Why Own the Farm If You Can Own  
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## I. INTRODUCTION: LEGAL ISSUES AND THE CHANGING NATURE OF GRAIN PRODUCTION

Access to improved genetic materials plays a fundamental role in the productivity of American agriculture. Farmers have viewed access to improved seeds in the same light as seed companies. If plant breeders produce better, high yielding seed, then farmers prosper, as do the companies. A question on the minds of many farmers is what role will biotechnology and genetic engineering play in the future of farming? A common assumption in U.S. agriculture is that biotechnology will expand both the crops produced and their potential uses. Biotechnology may well hold the key to answering the world's nutritional needs, to finding new industrial uses for agricultural products, and to creating new drugs. It may also bring riches to the plant breeders and genetic engineers who create the new plants and to the companies marketing them. But will it benefit farmers? Recently several agricultural companies have moved into production of identity-preserved or value-added crops such as high-oil corn. Value-added or identity-preserved production often relies on using production contracts with growers, who produce the end-use tailored varieties under contract for the seed company or the end user. Many farmers and companies hail contract production of identity-preserved crops as the future of agriculture, creating opportunities for new markets and price premiums for farmers. But will it mean new profits for farmers who raise the crops? Are there legal risks associated with agreeing to raise grain under production contracts? The use of contracts in agriculture has been most widely developed in poultry production, where over ninety percent of poultry is presently raised under contract. The remaining share is owned directly by large processors. In grain production, the development is still relatively new.<sup>1</sup>

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1. For a discussion of current national data on contracting in American agriculture, see Patrick M. O'Brien, *Changes in the U.S. Agricultural and Food Marketing*

Will all farmers have access to contracts to raise improved grains? If so, at what cost? If identity preservation means using production contracts, will this change how this nation farms? Will it change who buys crops, how they are priced, and the method of payment? Will it change whether farmers can save seed they raise, or sell some to their neighbors? What effect will it have on the traditional farm supply and marketing structure? To answer these questions it is important to examine two major developments in American grain production: First, the trend toward use of contract production for grain; and second, the connection between this development and the protection of intellectual property rights for seeds and plants.

The purpose of this Article is to survey the emerging legal issues associated with these two developments. The Article begins by reviewing the forces contributing to the increased use of production contracts and the reasons companies involved in grain processing and marketing are attracted to using contracts. The Article then considers the effect entering a production contract may have on the decision-making ability of farmers and the potential economic impacts of contracting. This discussion identifies a list of basic rules for farmers to consider when evaluating contracting opportunities. The next section of the Article is a more detailed discussion of selected legal issues which may be associated with use of grain production contracts. A variety of issues are discussed including the nature of the relationship, the forms of pricing terms used, and questions about the timing of payment. This discussion is followed by an inventory of the different clauses typically found in production contracts, illustrated with provisions from contracts currently being used in the Midwest. The Article then presents a preliminary analysis of selected issues identified by reviewing contract provisions, including several UCC contract questions commonly considered by courts. The section includes a discussion of the potential to use state legislation to regulate contracting practices. Finally, a comprehensive discussion of the issue of intellectual property protections applicable to the production of grains is presented. The discussion focuses on the impact such protections have on the ability of farmers to save their own crops as seed to plant or sell to other farmers. The Article concludes by discussing how the increased use of contracting for the production of grain crops has the potential to create a range of important legal and policy issues which may need to be addressed both at the level of individual producers and from the viewpoint of society as a whole.

## A. Trends in Grain Production

The primary reason for considering the legal issues associated with contract production of grain is the rapid increase in the use of such arrangements in American agriculture. Contracts have traditionally been used for the production of seeds and for many vegetable and horticultural crops. However, the use of contracting is now spreading rapidly into traditional grains as companies involved in processing or marketing grain products vertically integrate into crop production.<sup>2</sup> Use of contracts to control grain production is part of a larger trend toward use of contracts throughout agriculture, a trend which has been labeled as part of the industrialization of agriculture. The trend toward contracting has recently received increased public attention in relation to rapid changes in midwestern swine production. A recent report estimates that over twenty percent of swine are produced under contract, up from only two percent in 1980.<sup>3</sup> The same report indicates that seven percent of both food grain and feed grain production is raised under production or marketing contracts, an increase from less than two percent in 1970.<sup>4</sup> Some observers estimate that by the year 2000 as much as twenty percent of the nation's corn and soybean crops could be value-added or identity-preserved crops, which would mean a sharp increase in the use of contracting in grain production.<sup>5</sup>

The development of new marketing opportunities related to production of specialty or value-added crops has begun to receive considerable attention in the agricultural press. The articles generally focus on the opportunities for entering new markets or obtaining price premiums which may be associated with contract production.<sup>6</sup> The articles are an indication both of the increased level of contracting activity and the interest of farmers in learning more about the opportunities created by contract production of grain. Several different economic and agronomic forces have caused increases in contract production of grains. When considering the increase in grain contracting, several labels and concepts relating to the trend need to be understood.

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2. See Dirck Steimel, *Pioneer Makes Move up the Food Chain*, DES MOINES REG., Mar. 8, 1993, at 10S.

3. O'Brien, *supra* note 1.

4. O'Brien, *supra* note 1.

5. See Greg D. Horstmeier, *Farming By Invitation Only*, TOP PRODUCER, Feb. 1993, at 36.

6. See, e.g., Susan Davis, *A Profit Paradise?* SOYBEAN DIG., Feb. 1993, at 22; Rex Gogerty, *Farming for Factories*, THE FURROW, Nov./Dec. 1991, at 10; Dan Looker, *Encouraging New Grain Markets*, DES MOINES REG., July 14, 1991, at J1; Jeff Morgan, *Soybeans Grown for Specialty Markets, Iowans Grow 'Identity Preserved' Soybeans*, IOWA FARM BUREAU SPOKESMAN, Feb. 1993; Chester Peterson, Jr., *Food-Grade Corn Farmer*, SUCCESSFUL FARMING, Mar. 1993; Libby Powers, *Oil Fields on the Prairie*, TOP PRODUCER, Jan. 1993, at B2.

1. Identity-preserved grains: This term means crops for which the identity and thus unique characteristics of the grain are preserved from the time of production through marketing to processing and consumption. Identity-preserved grains may be those raised with uniquely altered genetics which give them higher values, such as better animal feeds, or it may mean crops raised under unique production methods.<sup>7</sup> A prime example is Pioneer Hi-Bred International, Inc.'s, "Better Life Grain" Program, where grains are raised under contracts in which producers agree to use no pesticides.<sup>8</sup> The grains are used by food companies, such as cereal makers, in preparing pesticide-free consumer products.<sup>9</sup> In this regard, organic food production is another form of identity preservation.

2. Specialty crop production: This term may relate to either production of non-traditional varieties or forms of grain such as waxy corn, white corn, or food grade soybeans; or the term may refer to raising identity-preserved crops. In some cases, specialty crop production can also refer to producing traditional grains but marketing the commodities for non-traditional or industrial uses. In either case, the attraction of specialty grain production is the ability to enter a new or niche market which will offer a price above that available in the public marketplace. Specialty grain production differs from identity preservation in that it may not be based on using unique plant genetics or production methods to result in the unique trait, but rather may just depend on the producer's ability to price or market the commodity for an alternative use.

3. End-use tailored varieties: This term is another way of describing the process of identity preservation, but with the focus on the work of plant breeders or genetic engineers in specifically designing a grain crop to express a trait which can result in added value.<sup>10</sup> The development of high-oil corn which has a higher value as an animal feed component is an example of an end-use tailored variety. The development of end-use tailored varieties such as high-oil corn is bringing a number of new companies into agricultural production. Du

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7. The development of identity-preserved crops is receiving considerable attention in the grain processing industry. See, e.g., Bill Freiberg, *Speakers from the Wet Milling Industry Tell of Their Big Future Demand for I-P Crops*, SEED & CROPS INDUSTRY, Feb. 1993, at 20.

8. 1993 Specialty Use Soybean Contract. "Better Life HP204" used by Pioneer Hi-Bred International, Inc. in Iowa [hereinafter Pioneer Better Life Soybean Contract].

9. For a discussion of this program, see Thomas N. Urban, *Agricultural Industrialization: It's Inevitable*, CHOICES, 4th Quarter, 1991, at 4.

10. For a thorough discussion of this development, see David Wheat and Wade Wilson, *Tailoring Grains for a Perfect Fit*, FEEDSTUFFS, May 13, 1991, at 1.

Pont, which has the rights to several high-oil corn varieties, has recently expanded into contract production of corn in Iowa.<sup>11</sup>

4. Value-added production: This is a more general and comprehensive term describing the process of producing commodities, such as specialty grains, which sell for a price premium. It can also refer to marketing traditional commodities in a way which increases their value or the producer's returns—for example, food grade soybeans or processing corn for ethanol.<sup>12</sup> In recent years, there has been much attention given in American agriculture to the search for new uses for traditional grain crops.<sup>13</sup> As part of the 1990 farm bill, Congress established the Alternative Agricultural Research and Commercialization Center (AARCC) as a special program within the USDA.<sup>14</sup> The AARCC has already received over \$10 million to fund research and development of such products.

5. Composition-based grain marketing: This term refers to a process for marketing commodities based on the value of the various feed components they contain, such as the starch and oil in corn. This type of marketing contrasts with traditional market grades or standards which do not separately value these traits. The issue of changing the way grains are priced and marketed has received considerable attention over the years in grain producing states.<sup>15</sup> For example, the state of Iowa, through the Department of Agricultural and Land Stewardship, has developed a program to promote composition-based grain

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11. See Karol Wrage, *Du Pont Enters the Seed and Grain Industry*, SEED & CROPS INDUSTRY, Dec. 1992, at 8; Veronica Fowler, *Du Pont Lab Set for Iowa*, DES MOINES REG., June 4, 1993, at 8S; and Dale Johnson, *Du Pont to Start Value-added Grain Market in Iowa*, IOWA FARM BUREAU SPOKESMAN, June 12, 1993, at 3.
  12. See Rex Gogerty, *Cashing in on Premium Markers*, THE FURROW, Mar./Apr. 1993, at 10.
  13. See Don Muhm, *Finding New Uses for Iowa's Surplus Crops*, DES MOINES REG., May 13, 1992, at 8S (Hearing in Cedar Rapids by the USDA's Alternative Agriculture Research and Commercialization Board); Don Muhm, *Project to Focus on Special Crops*, DES MOINES REG., May 17, 1992, at J1, (Project by Iowa cooperatives to market specialty grains raised by members).
  14. Food, Agriculture, Conservation, and Trade Act of 1990, Pub. L. No. 101-624, 104 Stat. 3359 (codified as amended at 7 U.S.C. § 5902 (Supp. IV 1992)). The AARCC program has published a booklet entitled "Making It Happen: Expanding the Use of Industrial Product from Agricultural Materials," which presents information on the variety of new uses and products funded with AARCC grants, including biodegradable packaging made from Kansas wheat and a new building material, "Environ," made with Minnesota soybean meal, which looks like stone but cuts like wood.
  15. In 1987, several grain states including Iowa, Minnesota, Nebraska, New Mexico, and Wyoming enacted legislation creating an Interstate Compact on Agricultural Grain Marketing Commission, which is working to develop new markets for grain, including the promotion of composition based pricing. See IOWA CODE ANN. § 183 (West 1990 & Supp. 1993); Dan Looker, *Encouraging New Grain Markets*, DES MOINES REG., July 14, 1991, at J1.



marketing. The Department held a conference on the subject on March 31, 1993, in Des Moines and published a catalog about the effort, referred to as the "Iowa Gold Catalog Program."<sup>16</sup> The catalog provides comparative information on the performance of different corn varieties as to the component production—for example, the percent of corn oil and starch. This information can be used by producers and processors in selecting which hybrids to plant.<sup>17</sup> The development of alternative methods to value and price grain in the public marketplace may receive increased attention in the future if concerns about the impact of contracting should develop. This is true because composition-based marketing, through publicly discovered pricing mechanisms, provides information and a market available to all producers. As such, it can provide an alternative to using production contracts, which internalize the specialized pricing mechanism, meaning the true value of the added traits are not revealed but instead negotiated between the parties. This practice can leave producers at a disadvantage when bargaining with the company which both developed the genetics and has control over the end-use market.

## B. Legal Significance of the Changes in Grain Production

Regardless of how the process is described, changes in the methods of producing and marketing grains are exciting and important developments for American agriculture. The trend is exciting because it may result in new markets, higher prices, price premiums, and even new ways of pricing and marketing grain for American farmers. Presently most of the public discussion of contracting focuses on the positive economic benefits associated with it. A recent survey by the University of Illinois found the majority of producers who have experience with contract production were satisfied and would continue to use it.<sup>18</sup> But while the economic benefits and opportunities may be real, potential concerns also can arise in connection with contracting. Issues concerning the impact of contracting on producers and the effect on the structure of agriculture need to be considered. The devel-

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16. For a discussion of the program, see Robin Henriksen, *Iowa Program Matches I-P Crops Suppliers with Buyers*, SEED & CROPS INDUSTRY, Oct. 1992, at 33.

17. For a discussion of some of the issues arising in connection with this development, see Mick Lane, *Conflict Over Composition*, SOYBEAN DIG., Apr. 1991, at 18; Mick Lane, *A Bonus for Better Beans?* SOYBEAN DIG., Apr. 1991, at 22.

18. See, Robin Hoffman, *'Super Farmers' Grab Crop Contracts*, TOP PRODUCER, May/June 1992, at 24, (discussing a survey done by a graduate student, Karen Coal-drake, at the University of Illinois' Food and Agribusiness Management Program). According to the Coaldrake survey, of the 250 farmers surveyed in east-central Illinois over 30% had at least one production contract. The survey also found that while growers noted the difficulties in satisfying contract terms, such as high quality standards, over 90% of those with contracts expressed an intention to continue contracting.

opment is important to the legal community and society for several reasons beside the possible economic impacts. Other important questions concerning the development of contract production include how it will change methods of producing and marketing of grain, what new legal issues may arise or be created, and how it reflects the industrialization of agriculture. This Article attempts to identify some of the issues which may be associated with contracting and explore the possible legal implications. By considering the actual language used in grain production contracts and the legal implications of contract production, individual producers and society can come to a more informed understanding of the possible impact and value of contracting.

### C. Relation of Contract Production to Industrialization

As noted in the introduction, the use of contracting for grains can be seen as part of the ongoing process of the industrialization of agriculture. Perhaps the best description of the industrialization of agriculture and how it relates to contract production was set forth by Thomas Urban.<sup>19</sup> Urban describes industrialization as the process whereby the production of goods is restructured under the pressure of increasing levels of capital and technology in a manner which allows for a management system to integrate "each step in the economic process to achieve increasing efficiencies in the use of capital, labor, and technology."<sup>20</sup> He has this to say about the change: "Production agriculture in the Western World is now entering the last phase of industrialization—the integration of each step in the food production system. The production is rapidly becoming part of an industrialized food system."<sup>21</sup> While not advocating the changes, Urban views the development optimistically, noting it will maximize uniformity and predictability in agricultural production allowing for branding of food and marketing of identity-preserved products, a development his plant breeders are actively pursuing. He believes it will attract capital to agriculture and lead to more rapid adoption of new technologies. He is also optimistic it will create opportunities for agriculture, possibly giving rise to a new family farm that is "dependent as much on financial management skills and contract marketing as on production and agronomy know-how"—a "super farmer" who will respond quickly to new opportunities to increase income and reduce risk.<sup>22</sup>

The development of specialty crops and industrial uses creates the potential for greatly expanded marketing opportunities and greater diversity in the mix of crops raised. But legal issues, such as producer

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19. Thomas Urban, *Agricultural Industrialization: It's Inevitable*, CHOICES, 4th Quarter, 1991, at 4.

20. *Id.*

21. *Id.* at 5.

22. *Id.*

access to contracting opportunities and the role of specialty crop production in spurring concentration of production, are real.<sup>23</sup> The trend toward increased contract production raises fundamental legal issues which will challenge both the farming community and agricultural lawyers. The increased use of contract production may raise questions both about the fairness of the contracts being offered producers and the economic effect of vertical integration in agriculture. Critics charge that contracting reduces farmers to low wage employees who assume most of the financial risks without the potential for increased returns.<sup>24</sup> As is discussed in a later section, some states, such as Minnesota, have responded to the trend toward agricultural contracting by enacting legislation to regulate use of production contracts and protect producers who enter such agreements.<sup>25</sup> If the new opportunities for specialty grain production and marketing are accomplished primarily through use of production contracts, as it appears is the trend, then lawyers will need to recognize the impact the use of contracts may have on producers, the companies using the contracts, and on the larger agricultural system and society.

#### D. Reasons Agricultural Companies Use Production Contracts

There are a number of reasons why companies involved in development or production of identity-preserved grains or specialty crops may insist the production be done using grower contracts.

1. Contracts provide control over the production methods and inputs used, thereby helping to insure uniformity and quality of the commodity produced and making it more suitable for preparing standardized consumer products.

2. Contracts offer a mechanism to control the quantity of crops produced and the manner in which they are marketed to processors and consumers, helping increase the price premiums obtained and prevent over supplies which may decrease demand.

3. Contracts allow the company to lock-in a guaranteed supply to meet potential needs, but to do so using pricing arrangements which limit the risk of having to acquire more crop than is needed or actually

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23. See Hoffman, *supra* note 18 (discussing some problems farmers encountered, such as the Frito-Lay decision to not contract with North Dakota potato growers who have less than 1,000 acres). See also Laura Sands, *Time Bombs In Your Contracts*, TOP PRODUCER, Mid-Feb. 1994, at 13.

24. See, e.g., Dan Looker, *Hog Feeding on Contract: Safe Money or Servitude*, DES MOINES REG., Aug. 15, 1989, at 1A; Cynthia Hubert, *Contract Poultry Farming Decried by Activists at Meeting*, DES MOINES REG., Feb. 2, 1992, at 3A.

25. MINN. STAT. ANN. §§ 17.90-17.98 (West Supp. 1994). See *infra* text accompanying notes 98-109. For a discussion of the Minnesota law, see Neil Hamilton and Greg Andrews, *State Regulation of Contract Feeding and Packer Integration in the Swine Industry*, DRAKE UNIV. LAW SCHOOL, WHITE PAPER 92-4, Nov. 1992.

marketed to users. For example, "passed acres" clauses, which are common in vegetable contracts, allow the company to not harvest or purchase the crop, even if it meets contract standards. Instead, the producer is paid a portion of the contract price from a pool of funds established by a charge on all contracts.<sup>26</sup>

4. Contracts may promote (or require) adoption or application of related technologies or production methods, some of which may also be marketed by the company, providing opportunities for economic linkages.

5. Contracts give the company control over the release of specialized crop genetics which may create the added-value trait, allowing the contract to serve as an additional form of intellectual property right protection to control the unauthorized reproduction of the crop.

6. Contracts offer a way to preserve the confidentiality of the pricing and marketing arrangements for the special commodity and the identity of the end-user or purchaser, which prevents producers from contacting the purchaser directly.

7. Contracts using non-public pricing and marketing of the commodities also allow for concealment of the true magnitude of any price premium obtained for the special trait, allowing the company to obtain higher corporate returns and limit the knowledge or ability of producers to bargain for a larger share of the added value.

8. Contracts give companies making investments in value-added crop breeding and genetic engineering a mechanism to project the company's financial interests, and thus potential returns, farther down the production process of the crop, without having to own the land or production facilities. This allows the company to increase the returns to the investors who funded the research which "created" the added value. It also allows the company to become involved more directly in crop production without worrying about investments in farmland, which are prohibited under the anti-corporate farming laws of several midwestern states.<sup>27</sup> The use of contracts may illustrate the attitude, "Why own the farm if you can own the farmer?"

When taken together these factors explain why many companies traditionally involved in agricultural sales, such as seed companies, chemical manufacturers, and grain merchandisers, are now contracting with farmers for production of commodities. The potential financial returns and market linkages also help explain why large corporations not traditionally involved in crop production, such as Du

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26. For a case involving a "passed acres" clause, see *Myron Soik & Sons v. Stokely USA*, 498 N.W.2d 897 (Wis. Ct. App. 1993), discussed *supra* in section III.A.2.

27. See *infra* text accompanying note 61. See, e.g., IOWA CODE ANN. § 9H (West Supp. 1993); NEB. CONST. ART. XII, § 8 (the constitutionality of which was recently again upheld in *MSM Farms, Inc. v. Spire*, 927 F.2d 330 (8th Cir. 1991)).

Pont, have recently decided to enter the area.<sup>28</sup> The development of contract production is another factor in the process of moving the economic activity of agriculture away from farmers and to the input or marketing sectors.

Stew Smith documented the decline of the economic contribution of farmers.<sup>29</sup> He observed that agriculture consists of three sectors: farming, the input sector, and the marketing sector. Each sector makes a contribution to the economic output of the collective food and agriculture economy. Between 1910 and 1990, however, the share of agriculture contributed by the farm sector dropped from twenty-one percent to five percent, with most of this shift being assumed by the input sector. Smith noted that the historic explanation for why farm numbers were declining—farmers were getting more efficient and society did not need them anymore—was in reality only half the truth. He wrote: "The whole truth would have also stated that much activity performed by existing farmers was being absorbed by nonfarmers, primarily in the input supplying firms."<sup>30</sup> Smith's perspective is that much of the shift is the result of how technology has been developed and employed in agriculture.

Smith also responded to the argument that the land grant university (LGU) research community has been biased toward larger farms, rather than being scale-neutral, by concluding both positions are wrong. He concluded that most LGU research has been sector biased.

Most agricultural research leads to more nonfarm activity at the expense of farming activity. This shift from farm to nonfarm reduces returns to farmers to cover opportunity costs and requires farmers either to increase production or utilize their excess management and labor in nonfarm pursuits. Indirectly the technology results in fewer and larger farms (in terms of commodity production) and more part-time farms, but the direct cause is the sector bias.<sup>31</sup>

Smith illustrated this analysis by contrasting the forces which have driven the development of a "high technology" input, such as the hormone bST, which can increase dairy production, with the lack of research on a management based technology, such as intensive rotational grazing, which may not result in a marketable input but can be as effective at increasing dairy productivity and farm profits.

It is no mystery why that alternative research was not conducted. There was no private sector to contribute funds to public research or to conduct its own research. But if there is a societal objective to maintaining farming, farms, and farming communities, we should have devoted public research to that alternative research.<sup>32</sup>

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28. See *supra* note 11.

29. Stew Smith, *Farming—It's Declining in the U.S.*, CHOICES, 1st Quarter 1992, at 8; George Anthan, *The Decline of Farming*, DES MOINES REG., May 10, 1992, at J1.

30. Smith, *supra* note 29, at 8.

31. Smith, *supra* note 29, at 9.

32. Smith, *supra* note 29, at 10.

The implications from Smith's analysis are apparent and timely, as is their application to the development of contract production of end-use tailored grains. The present agricultural system, from the research community to the input and marketing sectors, are all contributing directly to the loss of farm numbers. While Smith notes it may seem ludicrous to suggest farming could cease to exist in our agricultural system, he concludes:

Without substantial alteration of an array of agriculture policies, particularly technology development, the 80 year trend line of reduced farming activities will continue.

Biotechnology being developed today with the support of the LGUs will lead to a more industrialized system, with most farming activity conducted by part-time farmers and nonfarm firms performing much of the production activity away from the soil. Full time, family-owned and managed farming, as we have known it will cease to exist.<sup>33</sup>

One social issue associated with contract production of grain is whether the increases in economic activity accompanying the development will add to the incomes of farmers or whether the development will be one more factor contributing to the movement of the marketing and input sectors into agricultural production.

#### **E. Impact of Contracts on Farmers: Risk Sharing or Risk Shifting?**

Any farmer considering signing a production contract to raise a crop must reflect on the advantages and disadvantages offered by the contract. This will require not only an appraisal of the legal terms and financial incentives in the contract but also a consideration of what entering a contract means as to the farmer's control and decisionmaking authority. In traditional grain production without contracts, farmers have a full range of freedom and risk as to their decisions including what crops to raise, when and where to plant, how to produce the crop, where to purchase the inputs, when to harvest, when to market, and how to price the crop. The farmer is exposed to all the risks of the production, including market fluctuation—both up and down, poor weather, increased input costs, and other factors reducing production or returns.

In contrast, under a typical production contract, to obtain the promised price improvement the farmer may give up a considerable amount of control or flexibility in the conduct of the farm operation, including decisions regarding what crop to raise, when and where to plant, what production methods to employ, when to harvest, and to whom and when the crop is marketed. In exchange for this loss of freedom, the farmer generally obtains an advance assurance of a guaranteed market, perhaps at a fixed price, and usually some type of

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33. Smith, *supra* note 29, at 8.

price premium for raising the crop. The contract may reduce the risk of low financial returns; however, as the following review of contract terms reveals, under the language of most contracts, the majority of risk factors remain with the farmer. For example, the risk of a crop loss or increased input costs remains with the producer. In some cases even the promised price premium may be diminished because of adverse market movements or crop demand. Entering a production contract may even create new forms of risk not normally associated with crop production, including the risk of not being paid by the company, which may not be subject to state grain dealer laws, and the risk of having the commodity produced determined to be unacceptable under the contract for failing to meet quality or other specifications. Another significant risk of farming under contract is the risk of losing access to the special market in future years if the contract is not renewed.<sup>34</sup>

A related risk if contracts are terminated concerns the investments in buildings or equipment which might have been made in order to obtain the contract. A recent Iowa case, brought by a group of tomato growers against Heinz, is an example of a dispute over damages caused by the alleged breach of a crop production contract.<sup>35</sup> In this case, growers sought damages for recovery of such costs as the acquisition of expensive tomato harvesters after Heinz terminated their growing arrangements. The most significant issue in the case, and one which will undoubtedly be the subject of many future agricultural contacting disputes, was whether the court would find that the conduct or oral promises by the company operated to extend the contractual obligation beyond the one year period specified in the written agreement. Although, the suit was settled in January 1993, the terms of the settlement were confidential.

A final, and perhaps the most significant, risk of entering a contract is that if it fixes a sale price, the producer has lost the opportunity to take advantage of higher prices which might result from reduced supplies or other favorable market forces. This means one risk the farmer may not have under contract production is the opportunity to make a large profit from favorable price swings. The inventory of concerns, while negative in tone, does not mean all contract production relationships are unwise or risky. The true impact of contracting will be a function of the terms of the contract, the attitude of the company toward the growers, and the economic forces which influence production and prices. Contracts can be written which are balanced and equitable. For example, InterMountain Canola contracted

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34. For a discussion of experiences of farmers who have had problems with contract production relations, see Laura Sands, *Contracts Made to be Broken*, TOP PRODUCER, Oct. 1992, at 24.

35. See *Beachy v. Heinz*, CL. No. C6389-492, in the Iowa District Court for Muscatine County.

for production of over 75,000 acres of canola in western states in 1993, an increase in production from only 30,000 acres the preceding year. The reason for the increase was the company's use of an innovative contract which offered growers, among other things, a guaranteed per-acre payment, a guaranteed market for the harvested crop regardless of quality, a guaranteed contract price, and oil and yield bonuses.<sup>36</sup> Contracts which share the risks, rather than simply shifting the risks to the producer, are possible. But the development of such contracts may only be possible if producers and their attorneys work to insure such terms. It is unreasonable to rely on the good will of the company writing the contract and expect it to offer terms which protect the farmer's financial interests.

#### **F. Possible Impacts of Grain Production Contracting for Farmers**

When considering a possible contract production arrangement, it is up to the producer to consider why the increased economic returns are being offered. If grain production contracts result in increased economic returns for farmers, it is important to recognize the increased compensation will be in exchange for some action. Depending on the crop involved and the terms of the contract, the required action—in contractual terms, the consideration—from the producer, could be in the form of (1) increased production costs associated with complying with contract requirements; (2) reduced flexibility in how to farm and loss of control over pricing and marketing; (3) compensation for lower yields of the crop, known as the "production penalty," which can result if the specialized grains are less productive than traditional varieties; (4) compensation for the reduction in marketing due to the application of quality controls; for example, if the entire crop will not be marketable at the price premium; or (5) higher priced inputs for production; for example, if special seeds are required under the contract.

If contract production is being considered, farmers must recognize the changes which may be associated with producing crops under contract. The following discussion identifies several possible impacts on farmers, using examples of provisions taken from production contracts currently in use.

##### *1. Evaluation of Production Under the Contract Performance Terms*

To obtain promised price premiums, farmers will have to satisfy the contract by complying with its requirements. Contract production

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36. See Ed Narigon, *InterMountain Canola Doubles Contracted Acreage with a Contract Growers Can't Refuse*, SEED & CROPS INDUSTRY, June/July 1993, at 30.



may limit the flexibility to farm as desired. It introduces the risk that the crop produced will not be accepted under the contract. The following production clause illustrates this risk.

Production: The Grower shall furnish food bean crop that meets the following:

- a. Passed Field Inspection
- b. No. 1 Yellow Soybeans—14 PCT Moisture Maximum
- c. Free of dirty, green and or moldy seed
- d. Free of soil particles on the seed
- e. Free from varietal mixtures
- f. 40 PCT screenings Maximum
- g. Free from corn, nightshade, buffalo bur and cocklebur
- h. Free from green weed seed and pods that may cause bin spoilage

Any soybeans *not meeting these standards shall be disqualified from all premiums* and at Fairview Farms Inc. option, be released from this contract or purchased on the local grain elevator price schedule.<sup>37</sup>

## 2. *Access to Contracts, or Who Will Have the Opportunity to Participate?*

The answer to the above question, which was noted earlier, depends on the crop and the company involved in producing it. The factors which may determine if a producer has the opportunity to contract could include (1) whether a certain minimum size operation is required, (2) whether there are necessary investments in equipment, (3) the existence of a business relation with the contracting company, and (4) whether there are other added costs associated with the contract.<sup>38</sup> The requirement of additional capital investments may not be as significant with grain production as with contracting for other crops. Swine contracts, for example, typically require producers to construct new buildings to the contractor's specifications. But there can be new requirements as to machinery or production methods for grain production. As companies involved in marketing pesticides develop grain genetically engineered to be tolerant to their products, it is likely their production contracts will require use of these inputs. It may become common to see companies marketing packages of production technologies, including herbicides, seeds, and markets, all in the form of one integrated production agreement.

## 3. *Contracting may Change the Marketing and Payment System*

The contract may call for the direct delivery of the crop to the end-user or the contracting company, thereby bypassing local marketing outlets where the grain was typically sold. Similarly, depending on the crop involved and the contract, the pricing mechanism may bypass

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37. 1992 Seed Production Contract Used by Fairview Farms, Inc., Corwith, Iowa (emphasis added) [hereinafter Fairview Farms Soybean Contract].

38. See Greg D. Horstmeier, *Farming By Invitation Only*, TOP PRODUCER, Feb. 1993, at 36.

the traditional price discovery process. The price may be based solely on the contract term rather than the traditional methods of price discovery in marketing commodities, such as local cash prices or futures prices. This is common for production of crops such as vegetables for which there is not a public marketing system. A pea bean contract<sup>39</sup> used by Joseph Campbell Co. set the price term of the contract as follows:

PRICE: The price, delivered, per net cwt. of pea beans shall be:

(a) the quantity of cwt. of "Sound Beans" in the load (as such term is defined in "United States Standards for Beans" effective June 4, 1982), *reduced*, in case of loads which grade more than 18.0% moisture, by the applicable "Percent Shrink" for the load as shown on the attached "Schedule A";

*multiplied by*,

(b) \$19.00 per cwt., *less* the following deductions (if any) for the following conditions:

(1) Deduction for Cost of Drying;

(2) Deduction for Picking Charge to Remove Damaged Beans;

(3) Deduction for Removal of Corn, Soybeans and Contrasting Classes of Beans.

(c) Buyer will deduct, and pay to the Michigan Bean Commission, Grower's \$0 per cwt. assessment.<sup>40</sup>

Many grain production contracts provide a combined pricing mechanism which uses the traditional pricing system to establish a base price to which a price premium is added. Such contracts commonly give the producer flexibility to choose the date on which the base price is set. The contract will also identify any price premium the producer is to receive and any bonuses which can be earned depending on the quality of crop delivered. For example, the Pioneer Better Life Soybean Contract, provides:

II. The Company will pay the grower the base selling price for all bushels delivered basis US #1 Soybean with market scale of discounts to apply at time of delivery. Grower Acknowledges that the Base Selling Price will be equal to the current price quote for the delivery month of choice as quoted by the Company for the location stated above. Call the Pioneer SPP Grain Desk at 1-800-356-0393 for pricing information.

III. A premium of \$1.00 per bushel will be paid for the net bushels of clean food grade soybeans.<sup>41</sup>

#### 4. *Application of Price Discounts for Poor Quality*

One important pricing question which can arise under contract sales is the issue of the applicable level of price and quality discounts. It is common for a contract to provide that the final price is subject to "discounts to apply at the time of delivery" as in the Pioneer Better

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39. 1991 Pea Bean Contract used by Joseph Campbell Co. in Ohio, [hereinafter Campbell Pea Bean Contract].

40. *Id.*

41. Pioneer Better Life Soybean Contract, *supra* note 8.

Life Soybean Contract.<sup>42</sup> Producers may not realize the level of discounts applied within the grain trade can change significantly during a marketing period. For example, the discounts applied in the Midwest for low test weight corn were much smaller in the spring of 1993 than the discounts which were applied at the time of harvest in the fall. The poor growing conditions during 1993 resulted in a great deal of low test weight corn, with poorer feed value and less storage life.<sup>43</sup> The low test weight grain is also subject to discounts under the USDA's grain storage programs.<sup>44</sup> All of these factors meant grain elevators were less willing to purchase poor quality grain without applying significant dockage. Some elevators limited the amount of poor quality grain they took in storage by refusing to accept corn below a certain quality level.

#### 5. *Timing and Method of Payment may be Altered*

Instead of being paid on delivery as may be required under state law for normal grain sales, the contract may not require payment on delivery or sale but instead provide for installment payments or bonuses paid at later times. The Pioneer Better Life Soybean Contract provides:

7. GROWER PAYMENT: Payment (check issued and mailed) for soybeans sold prior to delivery will occur within 10 days after last delivery and acceptance date. Payment for soybeans sold after delivery and acceptance will occur within 10 days after selling date. The payment amount for each payment date shall include the appropriate premiums for the bushels sold. The Company shall have the right to deduct from the first payment any amount the Grower owes the Company for any reason whatsoever.

8. DEFERRED PRICING If Grower elects to defer pricing beyond the date the grower delivers his grain, he must sign a Price Later Agreement (Credit Sale Agreement).<sup>45</sup>

How the contract alters the timing for payment can also have implications under the grain dealer laws of a state. These laws may place time limits on when payment is to be made for grain. For example, dealers typically have to pay upon delivery and may be required to obtain bonds which are used to pay growers if the buyer should default.<sup>46</sup> However, if the contract alters the timing of payment, the producer may have transferred the title to the grain to the dealer but have only a contract claim for payment. The farmer's ability to receive compensation under a state grain dealer bonding law will depend on

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42. *Supra* note 8.

43. Charles Hurburgh, Jr., *Low Test Weights Surfacing in '93 Corn*, IOWA FARM BUREAU SPOKESMAN, Nov. 6, 1993, at 1.

44. Dale Johnson and Rick Robinson, *1993 Corn Harvest Bringing Low Test Weights; Sharp Discounts for Iowa Farmers*, IOWA FARM BUREAU SPOKESMAN, Nov. 6, 1993, at 1.

45. Pioneer Better Life Soybean Contract, *supra* note 8.

46. See, e.g., IOWA CODE ANN. § 203.8 (West. Supp. 1993).

whether the contract purchaser was considered a grain dealer. While issues of payment may not be significant when dealing with well-known publicly traded companies such as Pioneer or Du Pont, producers who are selling specialty crops to small or newly created grain marketing firms should take precautions to insure they will be paid for the grain once it has been delivered or the title has passed.

6. *Potential for Non-Production Reasons to be Basis for Termination*

If a farmer violates any clause of a contract, it may be a basis for the other party to treat the contract as having been breached. This is true even though the real reason the other party wants out of the contract is due to an adverse price movement or other market concerns. Quality provisions in contracts which leave the determination of compliance solely in the hands of the company, without any outside independent inspection process, create an opportunity for market factors to serve as the basis for rejecting the crop and finding the contract has not been performed.

## G. Basic Legal Rules of Contracting

Each grain production contracting experience will be unique depending on the nature of the relation between the parties, the terms of the offered contract, and the bargaining position of the parties. However, there are a number of common legal rules about grain contracting which lawyers and farmers should understand.

1. Read and understand any contract before signing. Contract terms play a fundamental role in determining the rights and duties of the parties. A good example is understanding the difference between a bushel contract, which commits a producer to delivering a fixed amount regardless of the crop actually raised, and an acreage contract, which promises delivery of whatever amount is raised on a designated number of acres. If the terms of a contract are not clear, a producer should consider having an attorney review it. Legal advice is an investment, not a cost, when it avoids confusion and prevents unfavorable economic decisions.

2. Compliance with contract terms is required; price premiums will not be paid unless the terms are satisfied. Failure to comply with the contract may subject the grower not just to lower returns, but to damages, penalties for breach, and other remedies. It is important to understand the contract provisions relating to default. Producers who, because of bad weather, are unable to satisfy a contract committing them to deliver a fixed number of bushels, might be surprised to learn they have to enter the market and buy higher priced grain to satisfy their obligation.

3. Know the contracting party and its financial and performance history. This knowledge is essential in helping insure the producer will be paid for any crops delivered. This knowledge is especially important if the contract calls for the passage of legal title when the commodity is delivered or for a delay in the payment. What happens if the buyer goes out of business or does not pay are questions that should always be considered before signing.

4. Weigh the advantages of the contract in terms of higher prices against any increased costs or risks. While a proposed production incentive such as a two dollar per bushel premium may appear attractive, it is important to calculate the real costs and risks presented by complying with the contract. Remember, the additional revenue is in exchange for something. Perhaps the unique variety of grain being raised has a significant yield penalty or preserving its identity will impose significant storage costs.

5. Contracts are always subject to negotiation. Just because a term is in writing does not mean it cannot be changed if both parties agree to do so. Of course this will depend on whether the producer has the power to negotiate with the company or whether there are other growers willing to sign the contract. If any changes are made in the contract, make sure they are in writing and separately signed by the company representative.

6. Remember the first rule of contracts—the parties who write the contracts take care of themselves. There is no reason to assume the contract being offered is either fair or protective of the producer's interests. Even though a grower may trust the company, grain production contracts are arms-length business transactions. This rule is especially important because in most contracting situations farmers are offered written contracts and have no real ability to negotiate or alter the terms.

7. Do not rely on oral communications made by the company either before the contract is signed or during performance. If what is being communicated is important to the relation be sure it is reduced to writing, signed by both parties, and incorporated as an amendment to the contract.<sup>47</sup>

## II. LEGAL ISSUES RELATED TO THE USE OF GRAIN PRODUCTION CONTRACTS

The preceding section has discussed how signing a contract for the production and marketing of grain has the potential to result in fun-

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47. For a case involving a dispute between a grower and a company concerning alleged oral modification in the payment and delivery terms of a sunflower contract, see *Neibert v. Schwenn Agri-production Corp.*, 579 N.E.2d 389 (Ill. App. Ct. 1991), discussed *infra* in text accompanying notes 112-116.

damental shifts in the nature of farming. The contract, because of its binding and enforceable legal nature, will also place new obligations and responsibilities on the parties, especially the farmer. To have a better understanding of the legal impacts of grain production it is worthwhile to consider some of the legal questions grain production contracts might create. It is possible to illustrate both the range of issues and their legal significance by considering the typical clauses used in current contracts.

### A. Nature of the Relation: What Legal Relation is Being Created?

One of the first questions which can arise under grain production contracts concerns the nature of the relationship created between the farmer and the company. The question can be very important in resolving subsequent disputes because it will determine how the courts will treat the parties in a variety of legal contexts, including such matters as potential liability for any damages caused or disputes over who has title to the crop. The answer to the question will be found either in the specific language of the transaction or by considering the actual nature of the relationship the parties created. The following types of relations are possible options under grain production contracts.

#### 1. *Simple Contract for Sale*

In a traditional forward contract, a producer agrees to sell an amount of a commodity at some date in the future. The relation created is simply one of a contract for the sale of goods. A forward contract generally does not call for any sharing of control over how the commodity is produced or contain any additional form of price enhancement based on performance of other contract terms. Instead it is merely an agreement to sell a certain amount of a commodity at a set price and at a future time.<sup>48</sup> Article 2 of the UCC applies to such contracts because they are for the sale of goods.

#### 2. *Independent Contractor*

Grain production contracts which call for the producer to perform special functions, such as to produce an identity-preserved crop or to employ specific production methods, typically characterize the relationship of the farmer to the company as being that of an independent contractor. Consider the following language from a 1989 Stokely USA, Inc. sweet corn contract:

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48. For a general discussion of the application of the Uniform Commercial Code (UCC) to these contracts, see Richard A. Malm, *Contracts for Future Delivery of Grain: An Overview of Common Legal Problems*, 2 AGRIC. L.J. 483 (1980-81).

**AN INDEPENDENT CONTRACTOR:** The Contractor hereby undertakes the production hereunder as an Independent Contractor and not as an employee of the Company. He shall have exclusive possession of the property upon which the crop is to be grown and shall not be subject to discharge by the Company, who holds no control over him in the performance of his contract other than as to the results to be accomplished. He may use such facilities and employ such labor as he desires to carry out this contract, and all persons employed by him for that purpose shall be his employees and not those of the Company.<sup>49</sup>

A somewhat different version of such a clause is found in a Du Pont corn contract. It provides:

**INDEPENDENT CONTRACTOR**

GROWER is for the purposes of this agreement an independent contractor and nothing contained in this agreement shall make GROWER an employee or agent of DU PONT or authorize him to act on DU PONT's behalf. GROWER shall indemnify and hold DU PONT harmless from any and all claims, in any way connected directly or indirectly with GROWER's operations pursuant to this agreement including GROWER's use of herbicides and insecticides. GROWER shall carry adequate public liability and property damage insurance.<sup>50</sup>

A third example of contract language designed to characterize the producer's status as an independent contractor is found in the Pioneer Better Life Soybean Contract.

This Contract represents the full and entire agreement between the parties. The parties agree that no change, modification, or alteration of terms and conditions of this Contract shall apply unless the same is in writing and signed by the Grower and the Company. The arrangement shall be one of independent contractors and not one of partnership, employment, joint venture or principal and agent. The Grower agrees to comply with all applicable local, state and federal laws, rules, and regulations.<sup>51</sup>

The reasons companies employ such language characterizing the relation of the farmer to the company as that of an independent contractor are apparent from the wide range of circumstances and potential liability they are attempting to avoid. An issue which would be worthy of further exploration, if a dispute arose concerning whether a producer was in fact an independent contractor, would be how the relation created under the contract would be evaluated under other legal tests for independent contractors. For example, the Internal Revenue Service has published its own list of twenty factors for determining whether or not an independent contractor or an employee relationship is established.<sup>52</sup>

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49. 1989 Sweet Corn Contract used by Stokely USA, Inc. [hereinafter Stokely Sweet Corn Contract].

50. Du Pont High Oil Corn Contract.

51. Pioneer Better Life Soybean Contract, *supra* note 8.

52. Rev. Rul. 87-41, 1987-1 C.B. 296.

### 3. *Personal Service Contract*

A third option for classifying the relation created under a grain production contract is to treat it as a contract for personal services, rather than as a sale of goods. A contract for the production of gourmet popcorn,<sup>53</sup> provided under "additional terms and conditions" the following:

Personal Services/Assignment: Grower and Company agree that this Agreement is, and shall be considered in the nature of a contract for personal services to be performed solely by the Grower and that a major consideration for its execution between the parties has been the Company's reliance upon Grower's expertise and ability to perform according to its terms. As such, this Agreement may not be assigned by Grower for any reason, either in whole or in part, whether by voluntary act or operation of law, except with Company's prior written consent. Failure of Grower to obtain said consent may, at the sole election of Company, be considered a material breach by Grower of this Agreement.<sup>54</sup>

Some courts have treated agricultural production contracts relating to raising poultry as agreements for the provisions of services rather than the sale of goods, which has a direct impact on the applicability of various UCC doctrines.<sup>55</sup>

### 4. *Bailment*

Another form of legal relation often specified in grain production contracts, especially those involving seed production, is bailment. In this regard, the characterization is not necessarily aimed at the party's working relation, but instead concerns the producer's relation to the seeds or plants being raised. As is discussed in Part IV, the company is opposed to the grower being determined to have any ownership rights in the seed used or produced under the contract. As a result, contracts for the production of seeds called "seedsmen contracts" have historically characterized the relation as a bailment.<sup>56</sup> There have been a number of cases analyzing the bailment theory as it relates to legal claims such as breach of warranty or financial claims such as mortgage foreclosures.<sup>57</sup>

It is not uncommon to find current crop production contracts, even those which label the relationship as that of an independent contractor, also containing language of bailment as to the producer's rights to

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53. Gourmet Popcorn Contract used by Beatrice/Hunt-Wesson in Indiana [hereinafter Beatrice Popcorn Contract].

54. *Id.*

55. *See, e.g.,* Smith v. Central Soya of Athens, Inc., 604 F. Supp. 518, 523 (E.D.N.C. 1985).

56. For a discussion of these issues, see Annotation, *Character Of Contract to Raise Seed*, 29 A.L.R. 647 (1924).

57. *See, e.g.,* Clements Farms, Inc. v. Ben Fish & Son, 814 P.2d 941 (Idaho Ct. App. 1990); First State Bank v. Simons, 13 P.2d 259 (Colo. 1932).



the seed. For example, the Du Pont High Oil Corn Contract includes the following paragraph:

**BAILMENT**

This is a Bailment contract. The parties agree that the seed, growing crops, pollen, tissues or molecular components, and the harvested crop (hereinafter collectively referred to as TOPCROSS) are solely owned by DU PONT.

a. GROWER hereby agrees to not give, transfer, or sell TOPCROSS material to any third party without written authorization by DU PONT.

b. GROWER agrees to use reasonable efforts to prevent access by third parties to TOPCROSS material.

c. GROWER shall return to DU PONT any seed not planted.

d. GROWER agrees not to grant or cause to be placed any lien or claim against TOPCROSS material.<sup>58</sup>

### 5. *Joint Venture, Partnership, and Employment.*

It is apparent from the preceding examples that companies do not desire grain production contracts to be classified in ways which would increase their potential financial exposure or risks. If grain production contracts were treated as contracts for employment, joint ventures, or partnerships, then potential legal liability could arise from a number of contexts including (1) environmental liability, such as related to pesticide use; (2) worker compensation, unemployment benefits, or other employee protections, both as to the grower and persons employed in connection with the crop, such as under the Migrant and Seasonal Agricultural Worker Protection Act;<sup>59</sup> (3) other forms of tort liability, such as for accidents caused by the grower in the performance of the contract; (4) liability for loss of the crop due to warranty issues, claims of defective inputs such as inferior seeds,<sup>60</sup> or reliance on adverse production advice; and (5) control of the property or engagement in farming, which might be contrary to the anti-corporate farming laws present in nine midwestern states.<sup>61</sup> If a contract is determined to give a company control over the production of the crop, or

58. Du Pont High Oil Corn Contract.

59. 29 U.S.C.A. §§ 1801-1872 (West Supp. 1994).

60. For an excellent discussion of the legal issues in defective seed warranty cases, see J.W. Looney, *Obstacles to Recovery in Defective Seed Cases*, AGRIC. L. UPDATE, March 1993, at 4, and J.W. Looney, *Obstacles to Recovery in Defective Seed Cases—Revisited*, AGRIC. L. UPDATE, Nov.-Dec. 1993, at 1, (discussing the recent decision in *Martin Rispen & Sons v. Hall Farms*, 621 N.E.2d 1078 (Ind. 1993)).

61. See for example the anti-corporate farming laws in Minnesota, Missouri, and Nebraska, which prohibit corporations from becoming directly or indirectly engaged in farming. MINN. STAT. ANN. § 500.24 (West 1990 & Supp. 1994); MO. ANN. STAT. § 350 (Vernon 1991); NEB. CONST. art. XII, § 8. These laws contrast with the approach taken in IOWA CODE ANN. § 9H (West 1994) concerning corporate farming, which addresses only the direct or indirect ownership of agricultural land. For a discussion of some of the issues related to corporate farming laws and contract production, see Keith D. Haroldson, *Two Issues in Corporate Agriculture: Anticorporate Farming Statutes and Production Contracts*, 41 DRAKE L. REV. 393 (1992).

ownership of the crop, it could be seen as being directly engaged in agriculture, which may be illegal under such laws.

Due to concerns about avoiding potential liability, most contracts employ language to limit liability, and courts have generally observed such provisions. However, there is at least one line of recent court opinions concerning the bailment issue which questions the true nature of contract production relations. In *Peterson v. Conida Warehouses, Inc.*,<sup>62</sup> the Idaho Supreme Court had to decide whether a contract between a tenant and a company could transfer the bean crop in such a manner that the landlord did not have a right to receive a portion of the crop in return for unpaid rent. The court held the landlord did have an interest, and in so doing it engaged in a review of cases concerning seedsmen contracts as bailments.<sup>63</sup> In a special concurrence, Judge Bistline questioned the wisdom of treating a production contract as a bailment.

I submit that it is unrealistic to continue to indulge in the fiction that a bean, which is irretrievably planted in the ground, and whose very existence as a bean ceases as it turns into a plant, may be the subject of bailment, entitling the supplier of the bean to claim all the beans produced from that plant. The parties essentially have entered into a joint venture, with the seed company supplying the seed beans, and the grower, here the Grimms, supplying the land in which the beans may be planted, together with all the labor which goes into planting, cultivating, harvesting, and hauling to the warehouse. The Idaho court, in our *Ferry Co.* case, in quoting from the *Montana Ferry Co.* case, came close to the right answer where it spoke of "a share of the net proceeds of the adventure." Here the grower's share was agreed upon at so much per hundred-weight, which seems to be what he was to receive for services rendered in the adventure, and not, by any stretch of the imagination, as compensation for storing the beans one inch apart in rows in the ground.<sup>64</sup>

If increased use of contracts for grain production results in an increase in litigation, courts may have the opportunity to evaluate the true nature of the legal relations being created under such arrangements.

## B. Inventory of Other Typical Provisions in Grain Production Contracts

The preceding discussion has identified several legal issues in contract production, including the nature of the relation, pricing methods, and the timing of payment. To understand more fully the potential range of legal questions which can arise under grain production contracts, it is valuable to review other provisions typically found in such contracts.

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62. 575 P.2d 481 (Idaho 1978).

63. *Id.* at 483-84.

64. *Id.* at 485-86 (citation omitted). This opinion was recently cited in a dissent by Judge Swanstrom in *Clements Farms, Inc. v. Ben Fish & Son*, 814 P.2d 941, 949-50 (Swanstrom, J. dissenting) (Idaho Ct. App. 1990), when he argued the bailment theory for interpreting seed production contracts should be rejected.

### 1. *Title to the Crop*

The contract provision relating to the title to the crop is important for purposes of determining who has the right to the crop at which times, a factor that can influence who bears the risk of loss or who can claim a financial interest in the crop. Consider the following clause from the Stokely Sweet Corn Contract:

**TITLE TO SEED AND CROP:** The title to the seed and the crops grown herefrom shall at all times be and remain in the Company, and the entire crop, except as herein otherwise expressly provided, shall be delivered to the Company. The Contractor shall not acquire any right, title, or interest in or to the seed furnished him nor the crops grown therefrom; and his possession of the seed and crop shall be that of a bailee only.<sup>65</sup>

Some contract provisions concerning title to the crop are interesting because they attempt to establish the company's ownership of the crop while at the same time attempting to place any risk of loss on the producer until the crop is delivered. Consider the following provision from the Beatrice Popcorn Contract:

**Title, Risk of Loss:** This Agreement is intended and understood by the parties to be effective when signed, and title to the growing popcorn crop shall pass to the Company immediately upon the sowing of the seed. However, until delivery and acceptance by Company, all risk of loss, damage or deterioration to the crop shall be borne by Grower, and Grower assumes all responsibility and liability incident to the planting, growing, harvesting, storage, shelling and delivery of the popcorn crop.<sup>66</sup>

### 2. *Risk of Loss*

As can be seen in the "title" provisions quoted above, the location of the title will help determine who bears the risk of loss of any crop failure. Some contracts, which do not call for passage of title until delivery, do include provisions on risk of loss. For example, the Fairview Farms Soybean Contract for the production of food grade soybeans provides:

**Risk and Entry:** Grower assumes all risk of loss of the Food Soybean crop while growing and/or after harvest until such time as Fairview Farms Inc. takes receipt thereof. Grower permits Fairview Farms Inc. to take samples from the field or the stored crop at any time.<sup>67</sup>

### 3. *Growing Obligations*

Because grain production contracts are usually employed with high value or specialty marketed crops, such as those for human food consumption, the contracts commonly include specific provisions concerning how the crop must be raised. This is especially true in production arrangements such as Pioneer Hi-Bred's Better Life Grain

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65. Stokely Sweet Corn Contract, *supra* note 49.

66. Beatrice Popcorn Contract, *supra* note 53.

67. Fairview Farms Soybean Contract, *supra* note 37.

program where the additional price premium is in exchange for meeting a series of production standards requiring avoiding the use of pesticides.<sup>68</sup> These obligations can also be reflected in the quality standards incorporated in the pricing or acceptance provisions, such as the standards for delivery of food grade soybeans quoted above. The following is an example of a provision for growing obligations, found in a Pioneer contract for the production of alfalfa seed.<sup>69</sup>

GROWING The Grower agrees to plant on land with proper crop history, to grow, care for in a good and farmerlike manner, harvest and transport the seed produced, except as otherwise expressly provided herein, according to the rules and regulations of the Official Certifying Agency; provided, however, that:

A. The Company, at its own expense, shall have the right to enter upon the land, "rogue" and do such work as it deems advisable for the betterment of the crop for seed purposes without any liability for damage, if any, to the crop resulting therefrom; and further provided that:

B. If at any time the Grower shall, in the Company's opinion, neglect, refuse, or for any other reason fail to carry out his obligations hereunder, the Company may, at the Grower's expense, use any means it deems necessary to properly care for, harvest, and transport the crop and otherwise complete the terms of this Agreement.<sup>70</sup>

#### 4. *Owner Approval of Contract: No Other Liens*

Another common provision in crop production contracts concerns the rights of third parties to the crop. The issue can involve either the claims of the landlord for rent, if the crop is produced on rented ground, or the claims of third party lienholders, such as banks which might have financed production of the crop. The Pioneer Alfalfa Seed Contract addresses the issues in the following clause:

##### OWNER'S APPROVAL OF CONTRACT

The Owner's approval of this contract is required when the Grower is not the Owner of the seed field. Therefore, the undersigned, being the Owner(s) of the premises heretofore described, does hereby consent to the foregoing contract and agrees that the rights of the Company under said contract shall be superior to any landlord's lien or other lien which the undersigned has, or may hereafter acquire, on the alfalfa crop grown on said premises from the stock seeds furnished by the Company.<sup>71</sup>

The bailment provision of the Du Pont High Oil Corn Contract includes a clause dealing with the rights of third parties. It provides,

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68. "The grower will sign an affidavit attesting that no pesticides have been applied to the soil or crop since the harvest of the previous crop and during the production season or while in storage." See Pioneer Better Life Soybean Contract, *supra* note 8.

69. Alfalfa Seed Contract, Pioneer Hi-Bred Int'l, Inc., Agri-Con Div. [hereinafter Pioneer Alfalfa Seed Contract].

70. *Id.*

71. *Id.*

"GROWER agrees not to grant or cause to be placed any lien or claim against TOPCROSS material."<sup>72</sup>

### 5. *Entire Agreement*

One provision found almost universally in grain production contracts is a clause providing the written contract is the entire agreement between the parties. The purpose of such a clause is to prevent subsequent attempts by growers to use oral modifications or other evidence to argue the terms of the agreement had been modified by the parties. The following is the integration clause contained in a corn contract:<sup>73</sup>

This agreement constitutes the entire understanding between the parties hereto. Except as set forth elsewhere herein, Neither (sic) Buyer nor Seller has any authority to alter, modify or assign this agreement or any part hereof without the prior written consent of the other party. No such alteration or modification shall be effective unless in writing and signed by the parties hereto. Any assignment made without such consent shall be null and void and of no effect. This agreement shall bind each of the parties hereto, their heirs, administrators, executors, successors and assigns.<sup>74</sup>

### 6. *Choice of Law*

Grain production contracts generally include a clause designed to select the forum for the resolution of any disputes which might arise. Not surprisingly, the provisions commonly designate the home state and county of the company as the applicable forum. For example, the Beatrice Popcorn Contract includes the following provision:

Choice of Law/Jurisdiction: This Agreement shall be construed and performed under the laws of the State of Indiana. The courts of Indiana, County of White, shall have exclusive jurisdiction over the parties in any action relating to the subject matter or interpretation of this Agreement.<sup>75</sup>

### 7. *Incorporation of Other Laws*

Many production contracts include provisions providing that other laws apply to the agreement. The other laws incorporated into grain production contracts may range from an agreement requiring the grower to comply with all environmental laws and worker protection requirements, to the statement the contract will be interpreted under the terms of the UCC. For example, the Du Pont High Oil Corn Contract states: "This Agreement shall be interpreted in accordance with the Uniform Commercial Code as adopted by the state of residence of

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72. Du Pont High Oil Corn Contract.

73. 1992-93 Waxy Corn Contract used by Farmer Cooperative Co. of Aurelia, Iowa [hereinafter referred to as the Farmer Coop. Corn Contract].

74. *Id.*

75. Beatrice Popcorn Contract, *supra* note 53.

GROWER.”<sup>76</sup> These clauses are important because they may obligate the grower to complying with laws which might not be applicable in a normal farming venture. An example of a considerably more detailed “incorporation of other laws” clause is found in the Beatrice Popcorn Contract.

Employment Standards: Grower agrees all popcorn contracted herein was or will be grown in accordance with the applicable provisions of Sections 6, 7 and 12 of the Fair Labor Standards Act of 1938, as amended, and the regulations and orders of the United States Department of Labor issued under Section 14 thereof, and agrees, whenever applicable, to comply with § 202(1) to (7), inclusive, of Executive Order No. 11246, as amended by Executive Order No. 11375, and regulations thereunder, the provisions and regulations of the Occupational Safety and Health Act, and § 503 of the Rehabilitation Act of 1973, and all other applicable regulations, including Affirmative Action for Handicapped Workers, 41 CFR § 60-741.4, and Affirmative Action for Disabled Veterans of the Viet Nam Era, 41 CFR § 60-250.4, and Public Law 95-507, Utilization of Small Business Concerns and Small Business Concerns Owned and Controlled by Socially and Economically Disadvantaged Individuals, as the same may be amended from time to time, and all of which are hereby incorporated by reference as though fully set forth herein. Grower agrees that he will furnish the Company with written certification of such compliance either ten (10) days after final delivery, prior to final payment hereunder, or at any other time during the term hereof when requested by Company.<sup>77</sup>

It may be fair to ask, without questioning the good intentions of any of the referenced laws, how informed any farmer's agreement to be bound by such laws is, given the fact most farmers have no idea what the laws require or how to find out. This raises a question about the effect of the grower's promise of compliance and certification. However, inclusion of such detailed incorporation clauses illustrates how entering grain production contracts may bring on unintended obligations and consequences of uncertain magnitude for farmers.

#### 8. *Other Miscellaneous Provisions*

An inventory of grain production contracts reveals there are a variety of other clauses which might be found, including provisions relating to severability, no waiver, attorney fees, disclaimer of warranties, intervening event or force majeure, dispute resolution, and length of contract and termination. While these provisions are not reviewed in this Article, each of the different clauses carries with it potential legal effects if a dispute should arise.

### III. ANALYSIS OF POTENTIAL LEGAL ISSUES UNDER GRAIN PRODUCTION AND MARKETING CONTRACTS

The provisions discussed in the preceding section raise a variety of legal questions which might need to be resolved if a dispute develops

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76. Du Pont High Oil Corn Contract, at para. 8.

77. Beatrice Popcorn Contract, *supra* note 53.

concerning a grain production contract. The following discussion analyzes several matters which could arise in grain contracting disputes.

### A. Issues From the Application of Article 2 of the UCC

The application of Article 2 of the UCC to most grain production contracts means a variety of traditional issues of contract law may arise. The most likely include whether the farmer is a merchant for purposes such as warranties and notification, accord and satisfaction in the acceptance of payment, notice of anticipatory breach, the measure of damages for a breach, and the duty to mitigate damages. Each of these issues has been the subject of litigation involving contract production and marketing of grain. The following discussion illustrates how courts have resolved the issues.

#### 1. *The Farmer as a Merchant*

A party's status as a merchant can influence many issues under the UCC, including whether or not there is a warranty of merchantability associated with the sale of goods and the rules which apply to determine if a contract offer has been accepted. Courts have divided on the issue of whether a farmer is a merchant. In *Colorado-Kansas Grain Co. v. Reifschneider*,<sup>78</sup> the issue was whether or not the statute of frauds applied so the oral agreement between the farmer and the company for the sale of grain did not create a contract. The court held the farmer was a merchant and thus the written confirmation from the company was sufficient to establish the contract.<sup>79</sup> As a merchant, the farmer had ten days to object to the written notice of confirmation. On the issue of whether the farmer was a merchant, the court defined a merchant as one "who deals in goods of the kind or otherwise by his occupation holds himself out as having knowledge or skill peculiar to the practices or goods involved in the transaction . . . ."<sup>80</sup> The court said that if a transaction is one between merchants then "both parties are chargeable with knowledge or skill of merchants" under section 2-104(3).<sup>81</sup> The Colorado court cited the cases which held that farmers may be merchants, recognizing "the fact that today's farmer is involved in far more than simply planting and harvesting crops. Indeed, many farmers possess an extensive knowledge and sophistication regarding the purchase and sale of crops on the various agricultural markets. Often, they are more aptly described as agri-businessmen."<sup>82</sup> The issue of whether a farmer is a

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78. 817 P.2d 637 (Colo. Ct. App. 1991).

79. *Id.* at 641.

80. *Id.* at 639 (citing COLO. REV. STAT. § 4-2-104(1)).

81. *Id.* at 639.

82. *Id.* at 640.

merchant is a fact for the trier. The court in *Reifschneider* looked at a number of relevant factors, including (1) the length of time the farmer had been engaged in the practice of selling his product to marketers of his product; (2) the degree of business acumen shown by the farmer in his dealing with other parties; (3) the farmer's awareness of the operation and existence of farm markets; and (4) the farmer's past experience with, or knowledge of, the customs and practices which are unique to the particular marketing of the product which he sells.<sup>83</sup>

Another case holding a farmer is a merchant in the sale of commodities is *Agrex, Inc. v. Schrant*.<sup>84</sup> The case involved a typical situation where a grower agreed to a forward contract for the sale of grain, and then the market went up. When the grower decided not to perform the contract the buyer had to enter the market and buy grain at a higher price. The buyer then sued to recover the damages. The legal issues were similar to those in the Colorado case and centered on whether the statute of frauds applied to the contract and the effect of the farmer's failure to reply to the written confirmation. The court ruled the contract was enforceable and the farmer was a merchant.

We therefore hold that experienced grain producers who regularly grow and market grain on the open market as the principal means of providing for their livelihood, and by reason of such occupation have acquired and possess knowledge or skill peculiar to the practices and operation of grain marketing, are merchants within the meaning of Neb. UCC 2-104 and 2-201 (Reissue 1980).<sup>85</sup>

Courts in Indiana, Michigan, Missouri, Nebraska, Ohio, Illinois, and Texas have all determined farmers may be merchants.

But the view that a farmer is a merchant is not universal. Courts in other jurisdictions, including Alabama, Arkansas, Iowa, Kansas, South Dakota, and Utah have ruled farmers do not become merchants simply by selling commodities they produce. For example, the Iowa Supreme Court ruled a farmer was not a merchant in *Sand Seed Service, Inc., v. Poeckes*.<sup>86</sup> The Iowa court looked at factors of the farmer's experience, such as that he did not deal in crops on the market but just sold what he raised, or that he had no business experience and only a high school education. The court set out a three prong test for when a farmer might be a merchant: (1) the farmer must be a dealer who deals in the goods of the kind involved; (2) the farmer must by his occupation hold himself out as having knowledge or skill peculiar to the practices or goods involved in the transaction; or (3) the farmer must employ an agent, broker, or other intermediary who by his occu-

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83. *Id.*

84. 221 Neb. 604, 379 N.W.2d 751 (1986).

85. *Id.* at 608, 379 N.W.2d at 754.

86. 249 N.W.2d 663 (Iowa 1977).



pation holds himself out as having knowledge or skill peculiar to the practices or goods involved in the transaction.<sup>87</sup>

Just a few years later, the Iowa court ruled that a farmer *might* be a merchant, depending on the facts of the transaction. In *Dotts v. Bennett*,<sup>88</sup> the court had to resolve a claim for damages made by the owner of cattle which died from eating hay purchased from the producer. The case involved two issues. The first issue was whether the buyer was relying on the seller's skill in purchasing the hay for purposes of establishing a breach of an implied warranty of fitness for a particular purpose.<sup>89</sup> The hay was later determined to contain mycotoxins which killed several cattle. The second issue was whether the seller was a merchant for purposes of an implied warranty of merchantability.<sup>90</sup> On the first issue, the court found no evidence of the required reliance and ruled it had been an error to consider that issue.<sup>91</sup> On the second issue, concerning an implied warranty of merchantability, the court held that substantial evidence supported the jury finding that the defendant was a merchant of hay as regarded the buyer.<sup>92</sup> The court held the instruction given the jury on the merchant issue was insufficient and remanded the matter.<sup>93</sup>

## 2. *Accord and Satisfaction in the Acceptance of Payment*

Another typical UCC sales issue concerns the doctrine of accord and satisfaction. This issue arises when one party claims that an accepted payment has served to resolve a dispute. A recent Wisconsin case involving contract production of sweet corn illustrates the application of this doctrine. In *Myron Soik & Sons v. Stokely USA, Inc.*,<sup>94</sup> growers of sweet corn brought a class action suit against Stokely over interpretation of their production contracts. The dispute arose over the amount farmers were paid for "passed acres," which are crop acres fit for harvest but not taken by Stokely. The contract specified growers would be paid for passed acres from a fund created with contributions from growers and the company based on the total tons of harvested crop. The contract provided if the fund was not sufficient to provide full compensation of nonharvested acres the payments would be prorated. Following harvest, the company notified growers the fund was insufficient for full compensation and the payments would be prorated on a calculation not yet determined. Shortly thereafter a

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87. *Id.* at 666.

88. 382 N.W.2d 85 (Iowa 1986).

89. *Id.* at 87.

90. *Id.* at 88.

91. *Id.* at 89.

92. *Id.*

93. *Id.* at 90.

94. 498 N.W.2d 897 (Wis. Ct. App. 1993).

second letter and checks prorating payments at 53.49% were sent to growers. At this point, the growers initiated action against Stokely on the basis the payments were inadequate; however, some of the plaintiffs cashed the checks. Stokely raised the defense that the checks had been calculated under terms of the contract so when growers accepted them it operated as an accord and satisfaction of the contract.<sup>95</sup> Stokely moved for summary judgment to dismiss the plaintiffs who had accepted the checks. The trial court denied summary judgment after concluding Stokely could not use accord and satisfaction as a defense.<sup>96</sup> The court of appeals reversed and remanded.<sup>97</sup> The appellate court concluded there was a dispute at the time the checks were cashed and the letters and correspondence gave growers notice the checks were meant as full payment for passed acres.<sup>98</sup> The court ruled Stokely could use accord and satisfaction as a defense, even though the letter accompanying the check made no specific reference to the provision or to the effect cashing the check would have on a grower's right to bring a subsequent claim.<sup>99</sup> The state of Wisconsin subsequently enacted administrative rules which limit the ability of a company to use passed acres clauses.<sup>100</sup>

### 3. Notice of Anticipatory Breach

Another issue which can arise in the production and marketing of grain under contract is what happens if the producer gives the company notice of an intention not to perform under the contract. For example, a producer could refuse to deliver grains which have been forward marketed. The issue involves questions both as to the appropriate amount of damages and what the buyer should do once it has knowledge of the grower's intention to breach the agreement. A recent Nebraska Court of Appeals case, *Trinidad Bean and Elevator Co. v. Frosh*,<sup>101</sup> involved a dispute between a Colorado bean buyer, which operated an elevator in Nebraska, and a farmer. On April 26, 1988, Elmo Frosh contracted with the Trinidad Bean and Elevator Co. in Imperial to sell 1,875 hundredweights of edible dry beans. The contract included two payment options. Option one provided for payment of \$16.25 per hundredweight on January 15, 1989. Option two provided for fifty percent payment at sixteen dollars per hundredweight upon the completion of harvest and for fifty percent at sixteen dollars per hundredweight on December 1, 1988. Choice of the first option

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95. *Id.* at 898.

96. *Id.* at 899.

97. *Id.* at 901.

98. *Id.*

99. *Id.*

100. See *infra* text accompanying note 142.

101. 494 N.W.2d 347 (Neb. App. 1992).

would allow a grower to defer income for tax purposes; however, both payment options were inadvertently marked on the contract with Frosh. When the contract was reviewed by the Denver office of Trinidad, the company contacted him about the need to determine which payment option he desired so the contract could be processed. After communication from the local elevator about correcting the error, Frosh returned to the elevator in early May 1988, and told them to tear up the contract. At that time the contract price and market price for dry beans were the same. When Frosh returned to the elevator on August 31, 1988, to make sure the contract had been torn up, he was informed the elevator still expected delivery. When he failed to deliver the beans, the elevator sued for the damages it experienced in buying beans, now at double the May price, because of a drought.

The jury found Frosh had violated the contract but was not responsible for any damages because the elevator knew in May he was not going to perform.<sup>102</sup> The appellate court affirmed, holding the contract was repudiated in May when there was no difference between the contract and market price.<sup>103</sup> Under section 2-713(1) of the UCC, the court determined that upon the anticipatory repudiation the measure of damages for nondelivery or repudiation was the difference between the market price at the time when the buyer learned of the breach and the contract price.<sup>104</sup> The elevator could not wait until the drought had driven prices higher and try to collect from Frosh. Instead it was limited to the damages from the difference of price in early May, when there was no difference. If there is a lesson in the case, it appears to be that if a party believes it has ended a contract to deliver commodities, it is important to make a record of the action and confirm that the buyer knows of the decision.

#### 4. *Measure of Damages for Breach*

The issue of what measure of damages to apply in a breach of contract action is not simple, as noted by the court in *Frosh*.<sup>105</sup> Under section 2-711(1), the buyer may cancel the contract and recover any amount paid, as well as seek damages for cover under section 2-712. This option is in addition to the one followed by the Trinidad Bean Co.—to choose not to cover and instead seek damages for the contract-market differential under section 2-713(1).

A recent Kansas case concerns the application of this provision. In *Tongish v. Thomas*,<sup>106</sup> Tongish had a contract with a local cooperative to grow 160 acres (later modified to 116.8 acres) of sunflower seeds

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102. *Id.* at 349.

103. *Id.* at 354.

104. *Id.* at 351.

105. *Id.* at 352-53.

106. 840 P.2d 471 (Kan. 1992).

and sell the crop to the cooperative for thirteen dollars per hundredweight for large seeds and eight dollars per hundredweight for smaller seeds. The cooperative had a contract to deliver the seed to Bambino Bean & Seed, Inc. at the same prices as Tongish was to be paid. The cooperative was to receive a fifty-five cent per hundredweight handling fee which was to be the cooperative's only profit under the agreement. The crop was to be delivered in one-third increments by December 31, 1988, March 31, 1989, and May 31, 1989. In January 1989, a dispute arose between Tongish and the cooperative because it was mixing Tongish's high quality seed with other seed. At that time the price for sunflower seeds was increasing because of weather and other factors. Tongish notified the cooperative he would not be delivering any more sunflower seeds. In May 1989, Tongish sold his remaining seed to Danny Thomas for twenty dollars per hundredweight. Tongish was paid by Thomas for approximately half of his seed. A dispute arose over who the seed belonged to, leading Tongish to sue Thomas for the remaining payment. Thomas deposited the money with the court to determine who it should go to, and the cooperative intervened, seeking damages for Tongish's breach of contract.<sup>107</sup>

The district court had to decide whether the damages should be determined by actual losses or the difference between market and contract prices. It found Tongish had breached the contract and awarded the cooperative \$455.51, or the amount it had lost in handling fees concerning the crop.<sup>108</sup> The court of appeals reversed and ordered that damages be determined by the difference between the market price and the contract price as required by Kansas law.<sup>109</sup> The Kansas Supreme Court affirmed the court of appeals, ruling the contract between Tongish and the cooperative obligated the cooperative to take the seeds whether or not it had a market for them.<sup>110</sup> The court therefore disregarded the fact that the cooperative had protected itself from market fluctuations through a subsequent contract to sell the seeds with a handling fee as profit. The court held the majority rule of market damages "encourages a more efficient market and discourages the breach of contracts."<sup>111</sup>

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107. *Id.* at 472.

108. *Id.*

109. 829 P.2d 916, 919 (Kan. Ct. App. 1992) (citing KAN. STAT. ANN. § 84-2-713 (1993)).

110. 840 P.2d 471 (Kan. 1992).

111. *Id.* at 476. The issue of the measure of damages also arises in connection with claims for breach of warranties. For an example of a grain marketing contract dispute involving claims for damages for breach of express warranty, in this case for delivery of spring wheat which was to be sold for seed, but which turned out to be winter wheat, see *Dakota Grain Co. v. Ehrmantrout*, 502 N.W.2d 234 (N.D. 1993).

### 5. *Oral Modifications of Contracts*

Another important issue which can arise in grain production contracts is the effect of oral modifications which are made once the production relation is underway. The question of how to deal with oral modifications involves several issues already addressed, including the effect of an integration clause, or provision in the contract noting that only written modifications are effective, and the question of the application of the statute of frauds.

A recent Illinois case involved oral modifications of a grain production contract. In *Neibert v. Schwenn Agri-Production Corp.*,<sup>112</sup> the Neiberts, Illinois farmers, contracted with Schwenn in 1986 to grow sunflowers on 612 acres and sell the seed to Schwenn's corporation. The corporation agreed to supply seed, pesticide, herbicide, and pick up seed from the farmer's storage. In exchange, the Neiberts would raise and harvest the crop and receive twelve cents per pound for seeds larger than 17/64th of an inch. After four loads of the harvested seed had been picked up, the Neiberts received their first payment and were surprised they were not paid for more of the seed. The company's position was that much of the seed was too small and was being priced at the lower rate. Negotiations began between the parties which involved the Neiberts flying to North Dakota for discussions about possible price reforms in the contract. The Neiberts left the negotiations believing the agreement had been modified so they would be paid ten cents per pound for small seed. Schwenn claimed he agreed only to pay for the small seed that had been delivered and for the first load following the negotiation meeting. In October 1986, Schwenn sent a letter to the Neiberts informing them further deliveries would be paid for under the original contract with no amendment. Schwenn claimed the Neiberts then said they would not deliver any more seed as of October 26. The Neiberts requested guarantees of payment in November, but Schwenn covered the contracts by purchasing sunflower seeds from other producers.

The Neiberts brought suit in March 1987 against Schwenn for breach of contract, and Schwenn counterclaimed, also for breach of contract. The trial court found the Neiberts had breached the contract since the contracts were not modified following the meetings in September. The Neiberts appealed, but the appellate court upheld the trial court's finding that the Neiberts were the party that breached the contract.<sup>113</sup> The appellate court agreed with the trial court's assessment that any modification needed to be in writing, and that the Neiberts breached the production contract.

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112. 579 N.E.2d 389 (Ill. App. Ct. 1991).

113. *Id.* at 391.

The suit also involved the question of the appropriate measure of damages for the Neiberts' breach. Schwenn argued it had intended to use the seed from the Neibert contract to satisfy a sales contract to Dalhgren for one million pounds at seventeen cents per pound. Schwenn argued that when the Neiberts refused to deliver more seed the company filled the contract with seed raised under contract with other growers. The trial court adopted Schwenn's method for determining damages and set damages at the figure of seventeen cents per undelivered pound of seed. The appellate court reversed the trial court's findings and looked to the UCC for guidance in assessing damages. The court found the proper measure of damages was the difference between the cost of covering the breach and the twelve cents per pound to be paid under the Neiberts' contract.<sup>114</sup> The court ruled Schwenn would have to show what was paid for the seed used to cover the Dalhgren contracts before the damages owed could be assessed.<sup>115</sup> The trial court also had included trucking costs and damages from disputes concerning how much seed and chemicals were used. The appellate court disallowed the trucking costs and found the Neiberts did not owe damages for chemicals they had correctly applied. The court also ruled the Neiberts owed Schwenn for ten bags of seed that were not used to plant or replant the 612 acres under the contract.<sup>116</sup>

## **B. Beneficial Interest Rules Under Federal Farm Programs**

Another area of potential concern for growers using grain production contracts is the impact the contracts might have on their eligibility to participate in various federal farm programs. The question here is whether the producer has retained a sufficient property interest in the crop so as to be eligible to receive farm program benefits or place the crop into the commodity price support loan program. Under the federal regulations which determine eligibility of producers to place commodities under price support loans, "a producer must have the beneficial interest in the commodity which is tendered to the CCC for a loan, loan deficiency payment, or purchase."<sup>117</sup> The rules provide that in determining whether a producer retains a beneficial interest, it may be necessary to determine if the crop was produced or marketed under a production contract. In such cases, the following test applies:

A producer shall not be considered to have divested the beneficial interest in the commodity if the producer retains control of the commodity, including the right to make all decisions regarding the tender of such commodity to CCC for price support, and the producer:

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114. *Id.* at 393.

115. *Id.*

116. *Id.* at 393-94.

117. 7 C.F.R. § 1421.5(c)(1) (1993).

(i) Executes an option to purchase, whether or not an advance payment is made by the potential buyer with respect to such commodity if the option to purchase contains the following provision:

"Notwithstanding any other provision of this option to purchase, title; risk of loss; and beneficial interest in the commodity, as specified in 7 CFR part 1421, shall remain with the producer until the buyer exercises this option to purchase the commodity. This option to purchase shall expire, notwithstanding any action or inaction by either the producer or the buyer, at the earlier of: (1) The maturity of any Commodity Credit Corporation price support loan which is secured by such commodity; (2) the date the Commodity Credit Corporation claims title to such commodity; or (3) such other date as provided in this option." or

(ii) Enters into a contract to sell the commodity if the producer retains title, risk of loss, and beneficial interest in the commodity and the purchaser does not pay to the producer any advance payment amount or any incentive payment amount to enter into such contract except as provided in part 1425 of this title.<sup>118</sup>

If farm program eligibility, such as the opportunity to receive deficiency payments, is an important part of a producer's calculation in entering a contract, it will be important to determine if the terms of the contract relating to matters such as the risk of loss, passage of title, and timing and method of payment leave the grower with sufficient beneficial interest.

### C. Agricultural Fair Practices Protections

Federal and state laws have been enacted to protect the rights of producers to organize and bargain when marketing commodities. The laws, in particular the Agricultural Fair Practices Act of 1968<sup>119</sup> (AFPA), have been used by poultry producers to challenge the manner in which their contracts were terminated.<sup>120</sup> Congress passed the AFPA to protect the right of farmers and ranchers to join with other growers to form associations to bargain for better prices and terms with handlers and processors. The Act sets out a number of prohibited practices for handlers, or persons engaged in "contracting . . . with . . . producers . . . with respect to production or marketing of any agricultural product . . ." <sup>121</sup> The Act focuses on prohibiting handlers from discriminating against, or intimidating, producers because of their membership in, or exercise of their right to organize, associations of growers.

118. *Id.* § 1421.5(c)(2).

119. 7 U.S.C. §§ 2301-2305 (1988).

120. For a discussion of the impact of contracts on poultry production, see Clay Fulcher, *Vertical Integration in the Poultry Industry: The Contractual Relationship*, AGRIC. L. UPDATE, Jan. 1992, at 4. An excellent source of information on developments with litigation involving poultry production contracts is the *Poultry Growers News*, published by the National Contract Poultry Growers Association, P.O. Box 824, Ruston, LA 71273.

121. 7 U.S.C. § 2302(a) (1988).

The Act was relied on by the federal courts in *Baldree v. Cargill, Inc.*,<sup>122</sup> a suit brought by Florida poultry producers alleging the defendant terminated their poultry contracts in response to efforts to organize other Florida growers. In *Baldree*, the Florida Poultry Growers Association and the U.S. Department of Justice sought a preliminary injunction forcing Cargill to reinstate its growers agreement with Arthur Gaskins, president and organizer of the association. The federal district court granted the preliminary injunction because it found there was a substantial likelihood the Growers Association and the Department would succeed in showing the agreement was terminated by Cargill. Specifically, the court found there was a substantial likelihood Cargill had attempted to discourage and prevent Gaskins from supporting the Association and to hamper the Association's claim against Cargill without economic justification in an unfair and unjustly discriminatory manner. The court cited the Packers and Stockyards Act<sup>123</sup> and the Agricultural Fair Practices Act<sup>124</sup> as authority for its decision. The dispute underlying the case concerned a suit Gaskins and other growers had filed against Cargill alleging various forms of fraudulent practices such as misweighing.

The importance of a statute such as the AFPA and cases such as *Baldree* in the context of grain production contracts is that such protections might become important if growers decide they need to organize to bargain for better contract terms. One result of contract production and agricultural industrialization may even be the need for farmers to consider collective action on a parallel to organized labor. Thomas Urban recognized this when he wrote:

We may even see farmers organize with like members of a system, or systems, as labor did at the turn of the century, to protect their interests in the face of contracts perceived to be unfair. They will certainly ask for, and receive, legislative protection at state and federal levels as labor has done in the past.<sup>125</sup>

#### D. State Regulation of Contracting

One response to the increased use of agricultural contracts has been that a number of states have considered legislation designed to protect agricultural producers who enter production contracts. The most important legislation has been enacted in Minnesota. The state has enacted several laws in recent years to go along with the existing anti-corporate farming statute which prohibits both farming and the ownership of agricultural land by corporations. One law amends the Minnesota Packers and Stockyards Act by placing reporting require-

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122. 925 F.2d. 1474 (11th Cir. 1991) aff'g, 758 F. Supp. 704 (M.D. Fla. 1990).

123. 7 U.S.C. §§ 181-231 (1988).

124. 7 U.S.C. §§ 2301-2306 (1988).

125. Urban, *supra* note 19 at 5.



ments on packers and stockyard owners.<sup>126</sup> They must now include in their annual report to the Commissioner of Agriculture "a copy of each contract a packer has entered into with a livestock producer and each agreement that will become part of the contract that a packer has with a livestock producer for the purchase or contracting of livestock."<sup>127</sup> Packers and grain and feed businesses with annual sales over \$10 million are required to keep a separate account for transactions relating to contract feeding of hogs, cattle, or sheep. The account may be audited at any time by the Commissioner of Agriculture.

A second law, enacted by Minnesota in 1990,<sup>128</sup> is the only state statute to date which directly regulates the provisions of agricultural production contracts. The legislation was the result of a report prepared by the "Agricultural Contracts Task Force" which was created by the 1988 Minnesota Legislature to explore the subject. The task force met fifteen times in preparing its report, which included a series of legislative proposals.<sup>129</sup> The law enacted as a result of this task force effort establishes a number of requirements for all "agricultural contracts," including the following requirements.<sup>130</sup>

1. Dispute resolution: The law requires that a "contract for an agricultural commodity between a contractor and a producer must contain language providing for resolution of contract disputes by either mediation or arbitration."<sup>131</sup>

2. Recovery of investment: When a producer is required by contract "to make a capital investment in buildings or equipment that cost \$100,000 or more and have a useful life of five or more years," the contractor must not cancel or terminate the contract until:

the producer has been given written notice of the intention to terminate or cancel the contract at least 180 days before the effective date of the termination or cancellation . . . [except when the producer abandons the contract or is convicted of an offense related to the contract business], and the producer has been reimbursed for damages incurred by an investment in buildings or equipment that was made for the purpose of meeting minimum requirements of the contract.<sup>132</sup>

3. Right to cure: If the producer breaches the contract, the contractor must give the producer sixty days to correct his breach and ninety days written notice before terminating the agreement.<sup>133</sup>

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126. MINN. STAT. ANN. § 31B.03 (West Supp. 1994).

127. *Id.*

128. MINN. STAT. ANN. §§ 17.90-17.98, 514.945 (West 1994).

129. See AGRICULTURAL CONTRACTS TASK FORCE, MINNESOTA DEPARTMENT OF AGRICULTURE, FINAL REPORT TO THE 1990 LEGISLATURE, (Feb. 1990).

130. MINN. STAT. ANN. §§ 17.90-17.98 (West. 1994).

131. *Id.* § 17.91.

132. *Id.* § 17.92.

133. *Id.*

4. Parent company liability: Parent companies of subsidiaries licensed to purchase agricultural commodities are "liable to a seller for the amount of any unpaid claim or contract performance claim if the contractor fails to pay or perform according to the terms of the contract."<sup>134</sup>

5. Implied promise of good faith: All agricultural contracts must be interpreted by the courts as including a statutory implied promise of good faith. If the court finds there has been a violation of the implied promise of good faith, the court may allow the party to recover "damages, court costs, and attorney fees."<sup>135</sup>

6. Return of prepayments: If a producer makes prepayments "for agricultural production inputs that include but are not limited to seed, feed, fertilizer, pesticides, or fuel for future delivery, the producer may demand a letter of credit or bank guarantee from the provider of the inputs to ensure reimbursement if delivery does not occur."<sup>136</sup>

The law creates a position within the Department of Agriculture "to provide information, investigate complaints arising from this chapter, and provide or facilitate dispute resolutions" relating to contract production.<sup>137</sup> The law also authorizes the Department to adopt rules to implement the various contracting provisions.<sup>138</sup> In 1991, the Department adopted rules pursuant to this chapter.<sup>139</sup> The rules provide further guidance on the interpretation of the provisions. One requirement added by the rules is that contractors using written commodity contracts must submit samples of contracts they propose to offer producers for review by the Department at least thirty days prior to offering the contracts to producers for signature.

Another Minnesota law, enacted in 1990, creates an agricultural producer's lien for products produced by an agricultural producer.<sup>140</sup> The lien is perfected by delivery of the agricultural commodity and is good for twenty days after delivery. It may be extended by filing within the twenty days but is void six months after filing. The agricultural producer's lien has priority over all other liens and encumbrances in the commodity. The lien extends to proceeds from the commodity, the proportionate share of commingled commodity, and products manufactured from the commodity.<sup>141</sup>

Another example of state regulation of certain aspects of production contracts is Wisconsin's rules regulating use of passed acres

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134. *Id.* § 17.93.

135. *Id.* § 17.94.

136. *Id.* § 17.97.

137. *Id.* § 17.95.

138. *Id.* § 17.945.

139. Minnesota Administrative Code, Chapter 1573, Department of Agriculture - Agricultural Contracts.

140. MINN. STAT. ANN. § 514.945 (West 1994).

141. *Id.*

clauses in vegetable production agreements. The rules restrict use of such clauses, regulate the method of funding payment pools, and require companies to pay the full contract price for passed acres which were suitable for harvest.<sup>142</sup>

The question whether state legislation will be needed to regulate the use of production contracts will largely be determined by the experience farmers have with such relations. This section of the Article has clearly demonstrated there is a significant potential for legal issues to arise in connection with contract production. To have a more complete understanding of why production contracts are becoming more common in grain production, it is necessary to consider the legal issues relating to the ownership and patenting of seeds and plant genetic materials. This is the focus of the next section.

#### IV. INTELLECTUAL PROPERTY RIGHTS AND CROP PRODUCTION CONTRACTS

The preceding section reviewed changes in grain production and the development of contract production. The trend toward contract production is directly related to development of improved plant genetics which can produce high value crops and grains genetically engineered for special uses. There is also a direct link between the trend toward contract production and the intellectual property right protections available for agricultural crops. As genetic engineering and improved breeding creates the potential for added value in grains, it is only natural for the companies investing millions of dollars to develop new crops to want to protect their financial interests in what they create. Companies will look for ways to claim rights further out of the production flow of a crop in order to capture part or all of the value they contribute. That is why companies such as Du Pont have decided to enter directly into the production of grain by opening subsidiaries engaged in contract production.

It is increasingly clear seed companies will not be content to simply sell improved seeds and profit from the higher prices charged. Instead, they may look for ways to control production of value-added crops so a portion or all of the enhanced value added by their breeding goes to them. Companies can do this in several ways. First, they can own or rent land and raise the crop themselves, but this is costly and even illegal for some companies in many midwestern states. Second, the companies could sell the seed to farmers and then buy back the production in the open marketplace for further distribution. If farmers can save the seed and replant it, however, this method risks losing

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142. WIS. ADMIN. CODE § Dept. of Agriculture, Trade, and Consumer Protection, 99 and 101. See *Ag 101: New Vegetable Contract Rule Benefits the Industry*, THE BADGER COMMONTATER, Jan. 1993, at 5.

control over the specially tailored genetics, which in turn could reduce the company's future ability to sell the seeds and capture their added value. Open sale of the improved seeds may also result in the extra value being lost if the public marketplace did not provide a way to value the additional traits. In such a case, poultry growers who buy high-oil corn might get a better quality feed ingredient without having to pay anyone for the improvement. A third approach is to contract with farmers to raise the crops and then sell them exclusively to the company for further marketing. This, of course, was the subject of the preceding discussion. In order to protect their interests in both the improved genetics and their ability to maximize the financial gains from the products, companies will utilize whatever laws are available. The laws which are most directly applicable are those for protecting intellectual property claims in seeds and plants.<sup>143</sup> As a result, the increased use of contract production in grain requires consideration of the existing range of intellectual property right protections available along with the emerging legal issues in their use.

#### A. Intellectual Property Rights for Seeds and Plants in the United States

The question of who will benefit from improved plant genetics will be in part determined by the forms of intellectual property rights available to those who create new plants. The United States is most advanced in applying the full range of intellectual property protections to living materials, including plants. Plant breeders have several options for protecting a new variety developed through traditional plant breeding or through biotechnology. The following are the different forms of intellectual property protections available to plant breeders and seed companies in the United States.

1. **Plant Variety Protection Certificates:** Plant breeders of new sexually reproducing varieties may claim "breeders rights" under the Plant Variety Protection Act (PVPA).<sup>144</sup> This approach is most commonly used for cross or self pollinating crops such as wheat and soybeans. The rights are sometimes referred to as patents but they are not true patents.

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143. This was the topic of a conference held in Washington D.C. in January 1993, sponsored by the Crop Science Society of America. The proceedings of the conference were recently published in CROP SCIENCE SOCIETY OF AMERICA, *INTELLECTUAL PROPERTY RIGHTS: PROTECTION OF PLANT MATERIALS*, CSSA SPECIAL PUBLICATION #21 (1993).

144. 7 U.S.C. §§ 2321-2583 (1988). See H.R. REP. NO. 1605, 91st Cong., 2d Sess. (1970), reprinted in 1970 U.S.C.A.N. 5082. For a discussion of the law, see Scott D. Wegner, *The Plant Variety Protection Act: Has the Farmer Exemption Swallowed the Act?*, AGRIC. L. UPDATE, Apr. 1992, at 4.

2. Plant patents: Plant breeders and companies who develop or find asexually reproducing plants, those reproduced using cuttings or scions of the original such as fruit trees, can claim a plant patent under the 1930 Plant Patent Act (PPA).<sup>145</sup> This Act, the first legal protection for plant breeders, was largely the work of an industry committee led by Paul Stark of the Missouri nursery family. Passage of the PPA was influenced by the difficulties experienced by famed plant breeder Luther Burbank in obtaining commercial rewards for his inventions.

3. Utility patents on plant varieties: The newest, and in some ways most controversial, protection for new plant creations is the patent law (referred to as utility patents, to distinguish from plant patents). Under a 1985 decision of the United States Patent Office, *Ex Parte Hibberd*,<sup>146</sup> a plant breeder may obtain a utility patent on a newly developed plant variety. The patent office decision to allow patenting of plant varieties was based on the 1980 United States Supreme Court decision in *Diamond v. Chakrabarty*,<sup>147</sup> approving patenting of living organisms developed by genetic engineering. Since these decisions, hundreds of patents have been issued for plant varieties. The application of United States patent law to plants has moved rapidly. The most extreme application of plant patents is the recent announcement by Agracetus, a Madison, Wisconsin based subsidiary of W.R. Grace, that it has received a patent for "all genetically engineered cotton."<sup>148</sup> In connection with announcing the broad-based patent, the Vice President of Finance for the company reportedly said "all transgenic cotton products, regardless of which engineering technique is used, will have to be commercially licensed through us before they can enter the marketplace."<sup>149</sup> The terms of the patent are:

Cotton seed capable of germination into a cotton plant comprising in its genome a chimeric recombinant gene construction including a foreign gene and promoter and control sequences operable in cotton cells, the chimeric gene construction being effective in the cells of the cotton plant to express a cellular product coded by the foreign gene, the cellular product imbuing the plant with a detectable trait, the cellular product selected from the group consisting of a foreign protein and a negative strand RNA.<sup>150</sup>

The claim could have a significant effect on cotton breeding programs, especially the many efforts underway to genetically engineer cotton to be resistant to various herbicides. If the patent is in fact determined

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145. 35 U.S.C. §§ 161-164 (1988).

146. 227 U.S.P.Q. (B.N.A.) 443 (1985).

147. 447 U.S. 303 (1980).

148. Karol Wrage, *Agracetus Claims Patent on "All" Genetically Engineered Cotton: The Beginning of First Big "Legal Monopolies" in Crop Development?* *AGBIOTECHNOLOGY NEWS*, Dec. 1992, at 1.

149. *Id.* at 4.

150. U.S. Patent 5,159,135, cl .1.

to be as broad based as claimed and if future developments lead to most U.S. cotton being genetically engineered in some way, then the company could have a profound influence on the cotton market, similar to Polaroid's influence with instant processing cameras. While it appears that such broad based patents are possible under U.S. patent law, the fact they are granted does not mean they will not be subject to challenge or limitation in actual application.<sup>151</sup>

4. Trade secrets on hybrids: In addition to these formal mechanisms, plant breeders have more informal ways of protecting their inventions. For example, breeders of hybrid seed corn use the law of trade secrets to protect the identity of their parent lines. This means that by protecting the identity of the parent lines from other breeders, companies can maintain control over the production of their hybrids. In other words, farmers cannot save seed to plant and obtain the same results because of the hybrid nature of the crop. The self-protecting nature of hybrids is one reason seed companies have experimented for years to hybridize other crops such as canola, cotton, wheat, and soybeans. With the exception of canola the efforts have been largely unsuccessful. In recent years there have been several highly publicized lawsuits involving seed companies fighting over the ownership of parent lines of hybrid corn.<sup>152</sup>

5. Other contractual protections: Companies marketing improved genetics may also provide seed to producers under contractual arrangements which commit the producer to not save or sell any of the harvested crop as seed. Such clauses may be used in addition to the protections found in the intellectual property laws, such as claims of patent infringement, or may be used alone. Some companies in the soybean business do not use the PVPA but instead rely on contractual provisions to authorize them to use breach of contract claims in local courts to enforce ownership of the seeds. The contractual claims concerning ownership of the seed are either included in the label when the seed is sold, as is done with limited use licensing for computer software, or on the purchase agreement.

An example of the inclusion of such a clause is the sales agreement used by an Iowa seed producer. The front of the sale bill provides "Terms on reverse side are a part of this Agreement. Read Carefully."<sup>153</sup> The back of the agreement has several detailed provisions in small print on matters such as limitation on warranties and a notice

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151. See *Control of Cotton: The Patenting of Transgenic Cotton*, RAFI COMMUNIQUÉ (Rural Advancement Foundation International) July-Aug. 1993.

152. For a discussion of litigation over ownership of seed lines in *Pioneer Hi-Bred International, Inc. v. Holden Foundation Seeds, Inc.*, 105 F.R.D. 76 (N.D. Ind. 1985), see Note, *The "Genetic Message" from the Cornfields of Iowa: Expanding the Law of Trade Secrets*, 38 DRAKE L. REV. 631 (1988-89).

153. See *Stine Seed Company Purchase Agreement* (copy on file with NEBRASKA LAW REVIEW).

of required arbitration. The intellectual property related provision reads:

Supplier represents and Purchaser hereby acknowledges that Supplier is engaged in the business of developing and supplying for sale various varieties of seeds. Supplier has a substantial investment in the development and production of Stine Brand Seeds and in the use of the subsequent production of the Stine Brand Seeds herein sold. Supplier has expended substantial effort in developing a market for Stine Brand Seeds. Supplier has existing contractual relationships with other purchasers and growers for the sale of Stine Brand Seeds and expectations of additional contracts for the Sale of Stine Brand Seeds in the future. In consideration of the foregoing and in consideration of the Stine Brand Seeds herein sold, *Purchaser hereby acknowledges and agrees that the production from the Stine Brand Seeds herein sold will be used only for feed or processing and will not be used or sold for seed, breeding or any variety improvement purposes.* Purchaser acknowledges Supplier's proprietary interest in the use of subsequent production from the seeds herein sold, and agrees it would be a violation of this agreement to allow the subsequent production of the seed herein sold to be used to create a seed variety or seed product from said production, which may be used for seed purposes by individuals or entities other than Stine Seed Company. Purchaser agrees and acknowledges that any use of Stine Brand Seeds, which is forbidden by this agreement, will constitute a misappropriation of the personal property of Stine Seed Company, and will therefore result in a breach of the agreement. Purchaser agrees that Supplier may bring an action in Dallas County, Iowa, to recover damages as a result of the breach of this agreement, along with reasonable attorney fees and costs associated with any action commenced in regard thereto. Purchaser agrees and acknowledges that any use of Stine Brand Seeds forbidden by this agreement will damage Supplier's legitimate expectation of future sales of seed and any use of Stine Brand Seeds in violation of this agreement will constitute an attempt to intentionally injure or destroy Supplier's prospective business expectations in future sale of Stine Brand Seeds. Purchaser agrees and acknowledges that any use of Stine Brand Seeds in violation of this agreement will cause a substantial damage to Stine Seed Company, and that if subsequent production of the seed herein sold is used to create a seed variety or seed product a substantial damage to Stine Seed Company for all seed varieties or seed products thereby created will be caused. This agreement shall not limit any other rights, legal or equitable, that the Supplier have but shall be accumulative.<sup>154</sup>

Restrictions on saving crops for future seed use are also commonly found in production contracts under which growers raise specialty crops for companies. For example, the following clause is from a contract used by an Iowa firm which contracts with farmers to raise specialty soybeans.

No Sales to Third Parties. Grower acknowledges that [company] has a valuable proprietary interest in the Parent Seed and Seed Crop. Grower agrees that he will not use for seed except under this agreement, not sell to or permit any other person to use for seed any of the Parent Seed or Seed Crop. Grower acknowledges that the legal remedies for the event of any actual or threatened breach of this covenant, in addition to any other right or remedy which [com-

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154. *Id.*

pany] may have, [company] shall be entitled to specific enforcement of this covenant through injunctive or other equitable relief.<sup>155</sup>

Some production contract clauses are written to provide the grower never has any ownership rights in the seed planted on the farm. For example, the Pioneer Alfalfa Seed Contract provides, in part:

III. Stock Seed

A. The Grower agrees to accept, as a bailee, stock seed of —, for seeding at the rate of — pounds per acre.

B. The grower agrees to return all unused stock seed to the Company within two (2) months from the date of receipt by the grower.

....

VII. General Terms

....

B. Title. The grower agrees:

1. That the stock seed furnished, the plant life produced and all seed grown under this agreement are and at all times shall remain the property of the Company,

2. That he will not use or sell nor permit any other person to use or sell for seed any of the crops produced from the stock seed furnished by the Company,

3. That he will not allow any of the vegetative cuttings or plants from the stock seed to be removed from his fields or control, except with express written consent of the Company, and further

4. That he will not commit any act permitting any other party to obtain possession of the seed in anyway whatsoever except as provided for hereunder.<sup>156</sup>

## B. How Intellectual Property Protections Affect Farmers

From the view of farmers, the most important issue about the different forms of legal protections is how they affect what producers can do with the seeds they raise. The most important issue is whether there is a right to save seed from one crop year and plant it in another. A related question is whether farmers can save protected seed and sell it to other farmers. Another issue is what happens if a farmer violates the law. The answer to these questions depends on two things: the nature of the crop involved and the law under which the seed is protected. With regard to hybrids, it is clear there is little a farmer can do with saved seed, as it will not breed true. In regard to seed sold under a contract restricting its future use or sale, the issue is whether the contract is enforceable. There have been few reported cases in the United States concerning such clauses. The enforceability of such a contract would depend on whether the buyer was aware of the provision and whether the courts would otherwise find it legal. The most important legal questions for farmers relate to seeds protected under the Plant Variety Protection Act (PVPA) or under patents.

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155. Soybean Seed Production Contract, Strayer Seed Farms, para. 17.

156. Pioneer Alfalfa Seed Contract, *supra* note 69.



### 1. *The Plant Variety Protection Act and Saved Seed*

In 1970, Congress passed the PVPA and gave the developers of novel plant varieties eighteen-year patent-like protection while creating a system for them to protect innovations from infringement. The law was enacted to stimulate private breeding activities for sexually reproducing crops such as soybeans by providing financial incentives for plant breeders. Since its passage, over 2,000 PVPA certificates have been issued. The Act is easy to use and plant breeders can complete the applications for a PVPA certificate without the services of a patent attorney. The Act has played a significant role in increasing private seed breeding activities in the United States.

#### a. *PVPA Exemptions*

An important aspect of the operation of the PVPA is the exemptions it contains. The most important are (1) a research exemption which allows "bona fide research" on protected varieties;<sup>157</sup> and (2) a farmer exemption which gives farmers the right to save seed for future uses, and in some instances to sell saved seed to other farmers.<sup>158</sup> In recent years the farmer exemption, also known as the crop exemption, has become very controversial to seed companies. Seed breeders claim under the exemption farmers are able to purchase PVPA protected seed, raise a crop, and then sell significant amounts to other farmers as seed, thus unfairly appropriating the research of the breeder and stealing their markets.

#### b. *Brown Bagging*

The practice of farmers saving and selling first generation protected seed is commonly referred to as "brown bagging" and is a fairly common, although unpublicized, practice in areas producing sexually reproducing crops such as wheat, soybeans, and cotton. The potential financial impact of brown bagging on seed research cannot be denied. For example, in 1990, Pioneer Hi-Bred International, Inc., decided to stop breeding hard red winter wheat in Kansas due to financial losses. Statistics show that in 1989 only eight percent of acres planted with Pioneer's variety 2157 were actually sold by Pioneer, the rest had been brown bagged by other growers.<sup>159</sup> As a result of incidents like this, the American Seed Trade Association (ASTA) has led efforts to amend the PVPA to limit the farmer exemption to allow only saving of seed for planting on the farm and to prohibit sales of saved seed to other farmers. However, Congress and the USDA (which administers the

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157. 7 U.S.C. § 2544 (1988).

158. *Id.* § 2543.

159. See Neil D. Hamilton, *Who Owns Dinner: Evolving Legal Mechanisms for the Ownership of Plant Genetic Resources*, 28 *TULSA L.J.* 587, 632-33 n. 142 (1993).

law) have not as yet passed amendments limiting the exemption. As a result, the main avenue for seed breeders to defend their legal rights in PVPA protected seed is to bring suit when they believe producers have illegally infringed their rights.

*c. What the Farmer Exemption Allows*

The controversy over the PVPA concerns the application of the farmer exemption, and in particular, a provision which authorizes farmers to sell saved seeds to other farmers. The main issue is whether the law places a reasonable limit on the amount of seed a farmer can save and sell to other farmers or whether the provision is a wide open exception to the plant breeders' rights. Section 2543 reads, in pertinent part, that:

it shall not infringe any right hereunder for a person to save seed produced by him from seed obtained, or descended from seed obtained, by authority of the owner of the variety for seeding purposes and use such saved seed in the production of a crop for use on his farm, or for sale as provided in this section: *Provided*, That without regard to the provisions of section 2541(3) of this title it shall not infringe any right hereunder for a person, whose primary farming occupation is the growing of crops for sale for other than reproductive purposes, to sell such saved seed to other persons so engaged, for reproductive purposes, provided such sale is in compliance with such State laws governing the sale of seed as may be applicable.<sup>160</sup>

The number of enforcement actions under the Act have been small, and few cases have reached the federal courts thus limiting the opportunities for courts to interpret the exemption. Two cases which have reached the courts are *Delta & Pine Land Co. v. Peoples Gin Co.*<sup>161</sup> and *Asgrow Seed Co. v. Kunkle Seed Co.*<sup>162</sup> One seed company in particular, Asgrow, has been very aggressive about enforcing its rights under the PVPA and has brought over twenty actions across the country. The most important brown bagging case recently arose in Iowa and is still being considered by the federal courts. The case of *Asgrow Seed Co. v. Winterboer*<sup>163</sup> pits one of the nation's largest seed breeders, a wholly owned subsidiary of the Upjohn Co., against a farm family from Clay County, Iowa.

*d. Asgrow v. Winterboer*

The facts in *Winterboer* provide a dramatic illustration of the stakes involved in brown bagging cases. Asgrow is a major agricultural seed company which has successfully developed and marketed varieties of soybean seeds. The Winterboers are family farmers who do business under the name DeeBee's Farm and Seed. Asgrow alleged

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160. 7 U.S.C. § 2543 (1988).

161. 694 F.2d 1012 (5th Cir. 1983).

162. No. 86 Civ. 3138-A (W.D. La. Apr. 1, 1987) *aff'd*, 845 F.2d 1034 (Fed. Cir. 1988).

163. 795 F. Supp. 915 (N.D. Iowa 1991).

its investigation revealed that the Winterboers were brown bagging Asgrow's seeds by harvesting and selling the seeds in non-descriptive brown bags, as being just-like Asgrow's varieties. An agent of Asgrow purchased seeds from the Winterboers, which were tested and determined to be Asgrow A1937 and A2234. Asgrow brought an action in federal court for an injunction against the Winterboers to not sell any seed for the 1991 planting season. The Winterboers did not dispute that Asgrow was the owner of a novel variety protected under the Act, nor that they had sold progeny of the novel variety—over 10,000 bushels in 1991. Instead, they claimed that over eighty percent of the soybean crop was sold for other than reproductive purposes and therefore, fell within the farmer saved seed exemption.

The language of 7 U.S.C. § 2543, under which the Winterboers sought shelter, defines an exempt farmer as a person, whose primary farming occupation is the growing of crops for sale for other than reproductive purposes . . .<sup>164</sup> Asgrow's position was that the farmer sale provision was limited by the concept of saved seed, meaning a farmer can only save what is necessary for replanting purposes and then sell portions of that saved seed if planting needs or intentions change. Asgrow argued that to read the exemption as broadly as claimed by the Winterboers would mean farmers could buy and raise protected varieties and then sell up to half of their crop to other farmers as seed. The company argued that such a broad interpretation of the saved seed exemption would not forward the congressional intent of the PVPA, which was to create economic incentives for plant breeders to develop and market novel varieties.

The federal district court granted Asgrow's motion for summary judgment and its request for a permanent injunction preventing the Winterboers from making sales of other than saved seed as defined by the court.<sup>165</sup> The court concluded Congress had not intended to give farmers an unrestricted right to sell seed, arguing that any other interpretation would have rendered the saved seed provision useless.<sup>166</sup> According to the court, the inclusion of "saved" to describe the amount of a seed a farmer is allowed to sell therefore "indicates a clear congressional intent to place limits on the amount of seed a farmer can sell to other farmers under the Act."<sup>167</sup> The issue then became how to quantify how much seed a farmer could save. The court concluded the "exception allows a farmer to save, at a maximum, an amount of seed necessary to plant his soybean acreage for the subsequent crop year."<sup>168</sup> Assuming soybeans are planted at a rate of one bushel per

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164. 7 U.S.C. § 2543 (1988).

165. *Asgrow Seed Co. v. Winterboer*, 795 F. Supp. 915, 920 (N.D. Iowa 1991).

166. *Id.* at 919-20,

167. *Id.* at 918.

168. *Id.* at 918-19.

acre, the court said this would mean if a farmer "could reasonably expect to plant 1500 acres of the protected variety in the subsequent crop year, the maximum amount of seed that could be classified as 'saved seed' would be 1500 bushels."<sup>169</sup> The court recognized "this interpretation of 'saved seed' restricts the number of bushel farmers will be able to sell to one another" but concluded "the purpose of Congress in enacting the PVPA was to protect the developer of a new line of seed and to allow a farmer to sell the prodigy of the novel variety as limited . . . ."<sup>170</sup>

The Winterboers appealed the district court decision to the United States Court of Appeals for the Federal Circuit, which has jurisdiction over PVPA appeals. In December 1992, the court reversed the district court and remanded the case for further proceedings.<sup>171</sup> The circuit court ruling is very important because it is a ruling of first impression on the question of the quantitative limit for the exemption. The appeals court held the "crops exemption" is subject to certain statutory limits but not a quantitative limit, or "ensuing crop" limit, as devised by the district court.<sup>172</sup> The court noted that neither the statutory language nor the legislative context for the 1970 act "suggest that the crop exemption contains an ensuing crop limitation."<sup>173</sup> The court acknowledged that "without meaningful limitations, the crop exemption could undercut much of the PVPA incentives. The Act, as written however, contains no ensuing crop limitation as determined by the District Court."<sup>174</sup>

*e. What the Winterboer Decision Means for Farmers*

The appeals court held the crops exemption is subject to the statutory limits found in 7 U.S.C. § 2543. The court identified the limitations to the crops exemption as applicable only when (1) the seed being saved, used, or sold, has been obtained by authority of the owner of the variety for seeding purposes; (2) sales are made only to other farmers; (3) the "primary occupation" of both the seller and buyer of the seed is "the growing of crops for sale for other than reproductive purposes;" and (4) the selling farmer remains subject to infringement under section 2541(3) and (4) of the Act concerning either "sexually multiplying the novel variety as a step in marketing, or using the novel variety in producing (as distinguished from developing) a hybrid or different variety."<sup>175</sup>

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169. *Id.* at 919.

170. *Id.* at 918-19.

171. *Asgrow Seed Co. v. Winterboer*, 982 F.2d 486 (Fed. Cir. 1992).

172. *Id.* at 490.

173. *Id.* at 491.

174. *Id.*

175. *Id.* at 489.

The court determined the crops exemption must be applied on a crops-by-crops basis, meaning "buyers or sellers of brown bag seed qualify for the crop exemption only if they produce a larger crop from a protected seed for consumption (or other nonreproductive purposes) than for sale as seed."<sup>176</sup> As applied, the test means a court "must determine the amount of crops a farmer grows for sale to consumers and the amount of crops a farmer grows for brown bag sales to other farmers."<sup>177</sup> If the farmer sells more to consumers than to other farmers as seed, then the farmer qualifies under the section "to buy or sell saved seed."<sup>178</sup> The court specified the exemption applies not just on a crop-by-crop basis but also to each novel variety.<sup>179</sup> This means a farmer's production and the amount eligible for sale under the exemption must be calculated for each novel variety produced. Therefore, a farmer who produced ten acres of one novel variety of PVPA protected soybeans out of a total of 100 acres of soybeans raised, could only sell as seed the production from less than half of the ten acres, rather than consider all soybeans produced. Variety by variety application of the exemption may increase judicial proceedings on alleged infringements.

Another issue courts will need to consider is the application of the limitation on marketing found in the infringement provision of 7 U.S.C. § 2541(3). A statutory conflict is created by providing that farmers brown bagging seed under section 2543 remain subject to the infringement provision for marketing. The appeals court recognized the conflict, noting that "an expansive reading of the term 'marketing' would swallow the entire crop exemption" which "explicitly permits farmers to make certain brown bag sales of novel varieties."<sup>180</sup> The court's answer was to define what marketing means in the context of section 2541(3). It ruled, "'marketing' in the context of the PVPA means extensive or coordinated selling activities, such as advertising, using an intervening sales representative, or similar extended merchandising or retail activities."<sup>181</sup>

There are several other practical implications from the ruling. First, the court ruled there is no second level brown bagging. In other words, a farmer who buys brown bag seed may neither save nor sell any of the crop produced as seed because the seed was not obtained "by authority of the owner of the variety."<sup>182</sup> This interpretation is subject to question, however, because the farmer exemption reads "to

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176. *Id.* at 490.

177. *Id.*

178. *Id.*

179. *Id.*

180. *Id.* at 492.

181. *Id.*

182. *Id.* at 490 (quoting 7 U.S.C. § 2543 (1988)).

save seed produced by him from seed obtained, *or descended from seed obtained*, by authority of the owner of the variety for seeding purposes."<sup>183</sup> Any seed produced from legally brown bagged seed would have descended from seed originally obtained under the authority of the owner of the variety. A second issue clarified by the opinion is that if a farmer's sales qualify under the crop exemption, they are not subject to most of the infringement provisions of section 2541, including the requirement of section 2541(6) that purchasers be notified the seed is a protected variety.<sup>184</sup>

## 2. Other PVPA Provisions

Even though the issue in *Winterboer* is still before the courts, farmers and attorneys must realize there are limits to the farmer exemption, and violating the law can result in expensive legal actions. The law provides if an infringement is found "the court shall award damages adequate to compensate for the infringement but in no event less than a reasonable royalty for the use made of the variety by the infringer, together with interest and costs."<sup>185</sup> The court may triple the damages if it desires, and in exceptional cases can award reasonable attorney fees to the winning side. A second feature of the farmer exemption is farmer sales must meet state requirements, such as labeling. The law reads, "provided such sale is in compliance with such State laws governing the sale of seed as may be applicable."<sup>186</sup> Thus, another claim a company could make in an infringement action is that the farmer sales did not meet state seed laws.

## 3. Seed Industry Efforts to Amend the PVPA

The Federal Circuit decision was a serious set back for the seed industry which had already embraced the district court ruling as a reasonable limitation on brown bagging. The company has since petitioned the United States Supreme Court to hear an appeal in the case, and the petition for certiorari was granted.<sup>187</sup> The decision has also led to increased efforts by the seed industry to get Congress to amend the PVPA to prohibit farmers from selling any saved seed to other farmers. Senator Kerrey of Nebraska recently introduced such a bill.<sup>188</sup>

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183. 7 U.S.C. § 2543 (1988)(emphasis added).

184. 982 F.2d 486, 492 (Fed. Cir. 1992).

185. 7 U.S.C. § 2564 (1988).

186. *Id.* § 2543.

187. *Asgrow v. Winterboer*, No. 92-2038 1993 WL 232929 (U.S. Apr. 18, 1994).

188. S. 1406 103d Cong., 1st Sess. (1993). See 139 CONG. REC. S10867 (daily ed. Aug. 6, 1993). Section 9 of the bill would amend 7 U.S.C. § 2543 by striking the proviso at the end of the first sentence, ("section: *Provided, That*") and all that follows through the period and inserting "section", meaning all farmer rights to sell

The attempt to amend the PVPA to prohibit farmer sales of saved seed is part of an effort by farmers to convince the United States to ratify 1991 amendments to an international treaty relating to breeders' rights. The United States was a party to the International Convention for the Protection of New Varieties of Plants (UPOV) in Geneva, an international treaty which protects the interests of plant breeders.<sup>189</sup> The treaty, amended in 1991, provides a farmers exemption allowing the saving of seed to plant a crop, but not to sell. The congressional debate will give farmers the opportunity to tell lawmakers how they feel about recognizing intellectual property rights in plants.

### C. Plant Patents and Exemptions: No Right for Farmers to Save Seed?

In recent years seed companies have also increased their use of utility patents to protect new plant creations.<sup>190</sup> One important issue concerning patents is what rights farmers have to save seed to plant in future years. The answer appears to be that there is no right to do so. Unlike the PVPA, patent law contains no express farmer exemption, meaning there is no right to save patented seed. In addition, there is no express research exemption, meaning plant breeders may not use patented seeds to further improvements without first receiving the permission of the patent holder and paying a royalty or license fee. The lack of exemptions to patents makes them attractive to the seed companies, but also raises issues concerning the impact on farmers and on plant breeding, particularly public breeding efforts. Will the granting of patents on new crops benefit agriculture and society? Will a scramble by private companies to claim ownership in plants further erode public plant breeding and encourage "industrialization" of agriculture? These are questions society, public plant breeders, and farmers must ask to clarify existing rules.

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saved seed would be eliminated. For a discussion of this proposal, see *New PVPA Amendments Proposed by Senator Bob Kerrey Would Bring U.S. in Line With UPOV*, DIVERSITY, vol. 9, no. 4 1993/vol. 10, no. 1, 1994, at 57.

189. International Convention for the Protection of New Varieties of Plants, Mar. 19, 1991. Hein's No. KAV 3102.

190. For a recent discussion of issues in plant patenting from the perspective of the U.S. Patent Office, see ELIZABETH C. WEIMAR, CROP SCIENCE SOCIETY OF AMERICA, UPDATE ON CURRENT STATUS OF PATENT FILINGS INVOLVING PLANTS AND OTHER RELATED ISSUES, CSSA SPECIAL PUB. #21, 79 (1993). For a report on the broader subject of crop genetics, see NATIONAL RESEARCH COUNCIL, MANAGING GLOBAL GENETIC RESOURCES: AGRICULTURAL CROP ISSUES AND POLICIES (National Academy Press, Washington, D.C., 1993).

## D. Intellectual Property Rights in Seeds and World Trade

Intellectual property protections for plants are also an issue for international trade.<sup>191</sup> The United States has pushed for their full recognition in international trade agreements. For example, in the GATT negotiations, the Trade Related Intellectual Property (TRIPs) Accord includes intellectual property protections for plants either in the form of patents, "breeders rights," or both, as does the North American Free Trade Agreement (NAFTA).<sup>192</sup> Concerns about the impact on biotechnology and property rights in plants were the reason the United States originally refused to sign the Biodiversity Treaty at the Earth Summit in 1992.<sup>193</sup> President Clinton signed the treaty in June 1993, but the issues still remain controversial.

Thomas Jefferson, who helped create our system of family farms, said, "[t]he greatest service which can be rendered any country is to add a useful plant to its culture."<sup>194</sup> Jefferson, who also wrote the nation's first patent law, was no doubt correct about the importance of adding new plants to our agricultural heritage, but the question is whether he would also have expected the person who "discovered" the plant or scientist who "engineered" the gene to own it. Ownership and control of the plant genetic resources will irreversibly shape the future of agriculture and are important issues for society. Farmers have perhaps the greatest interest in these issues and thus need to be aware what the laws provide.

## V. CONCLUSION: FUTURE ISSUES IN CONTRACT PRODUCTION OF GRAIN

This Article has considered a variety of legal issues which may arise in connection with use of contracts in grain production. The discussion has reviewed language found in contracts currently being used to identify the legal obligations imposed and to illustrate some of the legal questions which might arise if disputes develop. The Article has also considered recent court cases which help illustrate the practical application of existing contract laws to grain production relations. The important economic opportunities created by efforts to expand value-added production and marketing of identity-preserved grain crops means it is essential farmers and their lawyers have a better understanding of the impact of raising crops under contract. The increased use of production contracts, which will accompany these de-

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191. For a more detailed discussion of the impact of intellectual property rights in shaping agriculture, see Hamilton, *supra* note 159.

192. See Hamilton, *supra* note 159 at 613-17.

193. Convention on Biological Diversity, United Nations Environmental Program, June 5, 1992.

194. THE GARDEN AND FARM BOOKS OF THOMAS JEFFERSON 509 (Robert C. Baron ed., 1987).



velopments, will no doubt result in legal questions and disputes over interpreting contract language. Some of these issues will relate to protecting intellectual property rights in agricultural genetics and how these legal protections limit the ability of farmers to save and sell their seeds. The desire by seed companies and others involved in developing improved and higher value crop genetics to protect their investments is understandable. The United States has recognized an array of intellectual property laws which are available for this use. The development and interpretation of these protections, some of which—such as plant patenting—are now receiving their first extensive use, will add important legal issues to those shaping the future of agriculture. Protection of intellectual property rights in crop genetics is a factor contributing directly to increased use of contract production. Whether contract production of grain will provide an opportunity for farmers to improve their financial condition, or instead become a way in which farmers lose their independence to agricultural supply and marketing firms, will be an important question in determining the future structure of agriculture in the United States. Hopefully, this Article will prove of assistance to parties wrestling with these issues.